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IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-337

CHESTER C. DAVIS, *Petitioner,*

v.

UNITED STATES OF AMERICA, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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Petitioner Chester C. Davis prays that a writ of certiorari issue to review the opinions and judgment of the United States Court of Appeals for the Ninth Circuit, entered on May 7 and July 8, 1976, that reversed an order of the United States District Court for the District of Nevada dismissing the indictment herein for failure to state an offense.

OPINIONS BELOW

The opinion of the Court of Appeals is not yet officially reported. It is unofficially reported at [1975-76 Transfer Binder] CCH Fed.Sec.L.Rep. ¶95,560, and is set forth at page 27a of the separately-bound Appendix. The order of the Court of Appeals denying the petition for rehearing and "explaining and clarifying" its earlier opinion is set forth at page 58a of the Ap-

pendix. The order of the District Court is set forth at page 19a of the Appendix.

JURISDICTION

The judgment of the Court of Appeals for the Ninth Circuit was entered on May 7, 1976. A timely petition for rehearing was filed on May 14, 1976, and denied on July 8, 1976. On July 28, 1976, Mr. Chief Justice Burger entered an order extending the time for filing this petition to and including September 6, 1976. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. Consistent with Fifth and Sixth Amendment rights, may an appellate court uphold an indictment alleging a violation of the Securities Exchange Act of 1934 (the "Exchange Act") not by reference to any specific statutory provision nor to a specific rule or regulation but by declaring the charged conduct to be a crime based on the purpose of the Exchange Act as it perceives that purpose?

2. Must an indictment that purports to charge a violation of Rule 10b-5 of the Securities and Exchange Commission (the "Commission") allege that the defendant acted with a specific intent to deceive or defraud someone?

3. May Rule 10b-5 be construed to create an offense of trading manipulation that omits elements Congress specifically included in the definition of the offense of trading manipulation contained in Section 9(a)(2) of the Exchange Act?

4. Is it a crime to sell stock, or induce others to sell stock, on a national securities exchange, for the purpose of depressing the price of that stock even though the sales are real, not fictitious, and the stock was not sold in a deceitful manner?

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The constitutional and statutory provisions involved are set forth in the separately-bound Appendix beginning at page 1a. They include the following:

1. United States Constitution, Amendments V and VI.

2. United States Code, Title 15, Sections 78(i) and 78(j) (Securities Exchange Act §§ 9, 10).

3. Code of Federal Regulations, Title 17, Section 240.10b-5.

STATEMENT OF THE CASE

The indictment purports to charge a crime on the basis of alleged conduct "never heretofore branded improper by judicial decision, Commission rule or determination, or explicit Congressional act." (Concurring Opinion below, 55a.[1]) This alleged conduct consisted of guaranteeing three sellers of stock of Air West, Inc., ("Air West") against loss from sales on the American Stock Exchange. Allegedly these guarantees were given to induce directors of Air West to change their minds and accept an offer of Hughes Tool Company ("Hughes Tool") to purchase the assets of Air West, which the Air West shareholders

[1] References to page numbers of the separately-bound Appendix are in the format indicated in the text.

had approved but the directors had rejected by a narrow margin. (9a.) The alleged effect of the sales was to reduce the price of Air West stock on the American Stock Exchange on the date of the sales and to cause "the Air West stockholders who sold their stock in the declining market to receive the proceeds from their sales at artificially depressed prices." (10a.) The government has conceded that unless this alleged conduct violates Rule 10b-5 of the Commission, the indictment fails to state an offense. (33a.)

The indictment represents the second attempt to charge the petitioner, counsel for Hughes Tool, and the other defendants with a crime by reason of the alleged guarantee against losses. The District Court dismissed the earlier indictment as "the worst criminal pleading" it had ever encountered. (5a.) That indictment charged primarily that the guarantee against loss on the sale of the Air West stock constituted a manipulation of the market in violation of Section 9(a)(2) of the Exchange Act (15 U.S.C. § 78i (a)(2)). (27a-28a.) The government did not appeal from this dismissal. (*Id.*) Instead, it obtained a new indictment that does not charge a violation of Section 9(a)(2) nor does it allege, as did the first, that transactions in a security were effected on a national exchange "for the purpose of inducing the purchase or sale of such security", an essential element of the offense of market manipulation as defined by Congress.

Petitioner and other defendants moved to dismiss this second indictment for failure to state an offense. The prosecution concedes that there was nothing unlawful *per se* in guaranteeing a seller of securities against loss (5a) and that the sales were real, not

fictitious (26a). The indictment contains no suggestion that the sales were made in a deceptive manner, let alone in a manner that violated any specific rule of the Commission or at a price other than the price that obtained in a free market.

Because the indictment "alleges no false representation or half-truth or omission to state material facts made in connection with the purchase or sale of a security" (24a) and alleges no purpose to induce the purchase or sale of such security by others (22a), the District Court held that the conduct alleged did not violate any statute or regulation and dismissed the indictment.

The Court of Appeals reversed, solely on the basis of the general purpose of the Exchange Act to insure "fair and honest markets." Its opinion recognizes at the outset that "there has been very little litigation concerning the application of [Rule 10b-5] to market manipulation in corporate takeovers, and no case at all involving the specific conduct in which the appellees are alleged to have engaged." (36a.) In the absence of precedent, it turned to the legislative, administrative, and judicial history of the Exchange Act and Rule 10b-5 to determine whether the alleged conduct, if true, constituted an indictable offense. Reading Section 10(b) of the Exchange Act flexibly, not technically and restrictively, and Rule 10b-5 as a catch-all regulation operating independently of the statute, it held that market manipulation is a *per se* violation of Rule 10b-5 even if the "manipulation" does not contain the elements of market manipulation contained in Section 9(a)(2) of the Exchange Act and that the conduct alleged "falls within the type of activity which Con-

gress sought to prohibit in enacting the Securities Act and which Rule 10b-5 explicitly prohibits."

In a separate, concurring opinion, Judge Sneed:

(a) made clear that the court's decision was based upon its assertion of a residual power to outlaw conduct not proscribed by any statute, regulation, or decision, if that conduct offended the court's perception of a generalized underlying purpose of the securities laws (55a);

(b) recognized that the court was "eliminating *scienter*" from a criminal statute (57a);

(c) viewed the indictment as charging so-called "public welfare offenses" that "do not generally, and clearly not in this case, encounter the same demanding constitutional and interpretive standards applicable to other criminal offenses" (53a, 54a, 57a);

(d) conceded that the court's decision permits a prosecutor to indict on the basis of political considerations rather than legal standards (57a); and

(e) concluded that, although the law, as he read it, left him "no choice but to join my brothers," he found "no satisfaction or pleasure in doing so" (*id.*).

Nowhere in either opinion is there mention of this Court's decision in *Ernst & Ernst* v. *Hochfelder,* 96 S.Ct. 1375 (1976), which was decided after oral argument but prior to decision. Petitioner filed a petition for rehearing in which, *inter alia,* he pointed out the conflicts between the decision below and this Court's holding in *Hochfelder* that *scienter* is a necessary element of even a *civil* action under Rule 10b-5 and that Rule 10b-5 may not be used to nullify the carefully drawn restrictions of the statute as enacted by Congress. The court below denied the petition. It stated that it had considered *Hochfelder* but nonetheless deemed it advisable to explain and clarify the reasons for its conclusion. It concluded that its opinion was consistent with *Hochfelder,* citing the statement in its opinion "that it was necessary for the prosecutor to show an intentional act with 'a realization on the defendant's part that he was doing a wrongful act'" and the statement in the concurring opinion that "the intent necessary * * * is merely that of intending to do the acts prohibited, rather than intent to violate the statute." (60a.)

REASONS FOR GRANTING THE WRIT

On the basis of a claimed "residual power" to hold even in a criminal case that conduct is unlawful that does not violate the specific terms of any statute or regulation but rather offends against the general purpose of the Exchange Act, the Court of Appeals has reinstated the indictment against petitioner. Review by this Court is required because the decision does great violence to rights guaranteed under the Fifth and Sixth Amendments by the court's claimed residual power to subject petitioner to criminal prosecution for what neither he nor the grand jury that indicted him could know was a crime, and because (a) the decision disregards the teachings of this Court in *Hochfelder* that even in a civil action a court may not rely on a general purpose to create violations of the Exchange Act; (b) the court below has read out of the Act any requirement of *scienter* other than an intent

to do an act that a court later finds to be a violation of law, contrary to the holding in *Hochfelder* that an intent to deceive is an essential element of a Rule 10b-5 offense; (c) the holding of the court that "manipulation" is a *per se* violation of Rule 10b-5 is in direct conflict with the decision of the Sixth Circuit in *Marsh* v. *Armada Corporation,* 533 F.2d 978 (6th Cir. 1976), *petition for cert. pending,* No. 76-5; and (d) the court below has created a novel violation of the Exchange Act based on an intent to depress the price of a security without regard to whether a sale is a true sale or made in a manipulative manner.

The effect of the court's holding, as the concurring opinion below recognized, is to permit criminal indictment on the basis of no firmer a standard than which way a prosecutor determines the political winds are blowing, and to return to the case-by-case method of determining what is or is not a violation of the Exchange Act which this Court found to be an unjustifiable burden on the federal courts in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975).

A. Conflict with Hochfelder—The Need for Review with Respect to Statutory Limitations on the Scope of Rule 10b-5 Liability

The use of a catch-all rule to make unlawful on the basis of a general purpose of the Exchange Act what is not proscribed by statute or specific regulation does tremendous violence to due process of law. It subjects petitioner to criminal prosecution for an offense created by judicial fiat in the midst of a criminal case. This use of the purpose of the Act to create a violation is fundamentally at odds with this Court's decision in *Hochfelder.* The judicial creation of a violation of the

Act would not be permissible under *Hochfelder* even if this were a civil action.

The Exchange Act contains a precise definition of what is an unlawful manipulation. The opinion of the court below recognizes that an allegation that stock was sold for the purpose of inducing the purchase or sale of such stock by others is essential to the offense of market manipulation as defined in Section 9(a)(2) of the Exchange Act. Although the prosecution was well aware of this requirement from proceedings on a prior defective indictment, there is admittedly no such allegation in this indictment. The prosecution was unable to charge the offense proscribed by Congress.

The court below attempted to cure the defect by holding that the allegation required by Congress is unnecessary because Rule 10b-5 "operates independently" of the statute, and Section 9 of the statute "cannot be read as a limitation on Rule 10b-5". The court used the general language of Rule 10b-5 to exclude elements from the definition of unlawful market manipulation that Congress specifically included. But in *Hochfelder,* this Court rejected the contention that Rule 10b-5 could be "viewed in isolation" (96 S.Ct. at 1390). It stated that " 'the interdependence of the various sections of the securities laws is certainly a relevant factor in any interpretation of the language Congress has chosen * * *.' " (*Id.* at 1397.) It held that the general language of Rule 10b-5 may not be used to nullify the express and carefully drawn restrictions of the statute. (*Id.* at 1389.)

For this reason, this Court in *Hochfelder* expressly rejected the same contention that the Court of Appeals uses as a justification for its decision. In *Hochfelder*

the SEC argued in terms almost identical to those used in the opinion below (compare 37a and 39a to 40a with 96. S.Ct. 1383-1384), that the broad remedial purposes of the statute permitted the Court to proscribe conduct not prohibited by the terms of the statute or rule. Rejecting the notion that a court could "draw on some unexpressed spirit outside the bounds" of the statute to outlaw an "effect" thought to contravene a general statutory purpose (96 S.Ct. at 1383 and 1384, n. 19), this Court held:

> * * * Rule 10b-5 was adopted pursuant to authority granted the Commission under § 10(b). The rulemaking power granted to an administrative agency charged with the administration of a federal statute is not the power to make law. Rather, it is "the power to adopt regulations to carry into effect the will of Congress as expressed by the statute." * * * Thus, despite the broad view of the Rule advanced by the Commission in this case, its scope cannot exceed the power granted the Commission by Congress under § 10(b). [96 S.Ct. at 1390-1391.]

The holding of the court below that Section 9 of the Exchange Act is not a limitation on Rule 10b-5 is flatly contrary to *Hochfelder*. By ignoring this Court's teaching in *Hochfelder,* the court below created a crime that was of its own making, not that of Congress. The rationale of *Hochfelder* has special force in this criminal prosecution, where it cannot be overlooked that "legislatures and not the courts should define criminal activity." *United States* v. *Bass,* 404 U.S. 336, 348 (1971), and where due process requires that fair warning be given, "plainly and unmistakably," that particular conduct is a crime. *Id.*

The decision below invites exactly the kind of "endless case by case" determinations, under no set standard other than whether the facts alleged constitute conduct that in the court's view violates a general purpose, that this Court found to be an unjustifiable burden on the federal courts in *Blue Chip Stamps* v. *Manor Drug Stores, supra,* 421 U.S. at 755. Moreover, like the Ninth Circuit decision reversed in *Blue Chips,* the lack of any standard makes it all but impossible to weed out, prior to trial, those cases that justify the burden and expense of protracted litigation from those that do not. *Id.* at 739-743. And the lure of appellate review is all but irresistible because one judge's perception of what offends a generalized purpose may well differ from another's. For these reasons as well, an early and definitive decision is necessary to set to rest, once and for all, the troublesome and recurring question as to the substantive reach of Rule 10b-5 and to apply the principles announced in *Hochfelder* to that question.

B. Conflict between the Circuits: Manipulation as a per se Violation of Rule 10b-5

The fundamental defect that permeates the entire opinion of the Ninth Circuit is its failure to correlate the conduct charged in the indictment with the terms of the statute and rule alleged to have been violated. The court below states that clauses (a) and (c) of Rule 10b-5 are a "flat prohibition" against "market manipulations." (41a.) But neither clause (a) nor clause (c) of Rule 10b-5 mentions "market manipulations" and the flat prohibition, as the concurring opinion below recognized, is not to be found in the Rule. (55a.[2])

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[2] Clauses (a) and (c) of Rule 10b-5 make it unlawful, in connection with the purchase or sale of a security, (a) "to employ

The holding of the Ninth Circuit that Rule 10b-5 contains a flat prohibition against market manipulation conflicts with the decision of the Sixth Circuit in *Marsh* v. *Armada Corporation, supra,* now pending in this Court, No. 76-5. That case was decided after oral argument in the court below but prior to the issuance of the court's opinion and was cited to the court in the petition for rehearing. In that case, the Court of Appeals for the Sixth Circuit held that Section 10(b) and Rule 10b-5 do "not flatly prohibit the use of a manipulative device" but rather prohibit only such conduct as, upon analysis, constitutes unlawful deception within the terms of Rule 10b-5. *Marsh* v. *Armada Corporation, supra,* 533 F.2d at 983.

In the *Marsh* case, the Sixth Circuit properly analyzed the conduct at issue so as to ascertain whether it involved unlawful deception. In sharp contrast, the opinion of the Ninth Circuit ignores the specific terms of the statute and rule alleged to have been violated and by so doing, in this case, creates a crime in a statutory vacuum of its own making. Quite apart from the violence that this judicial creation of a crime does to petitioner's Fifth and Sixth Amendment rights, review by this Court is required to resolve this conflict between the circuits on this important issue as to the proper application of the securities laws.

C. A Second Departure from Hochfelder: Scienter

One would have thought that this Court's opinion in *Hochfelder* settled with finality the necessity of a

any device, scheme, or artifice to defraud" and (c) "to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person • • •."

specific intent to deceive or defraud, at least in a private action under Rule 10b-5. And if that intent is required in a private civil action, then, *a fortiori,* it is a necessary element in a criminal prosecution under the same rule. Nevertheless, the court below decided that Rule 10b-5 requires no specific intent to deceive or defraud and holds that it is sufficient if there is some ill-defined generalized intent to do the act that the court finds violates the rule.[3]

It is impossible to find in the indictment who it was that petitioner allegedly intended to deceive or defraud in connection with the purchase or sale of a security. The government claims the objects of the deceit were those who sold their Air West stock when the market price declined. (17a.) The claim is ridiculous. The indictment carefully omits the charge that the sales were made for the purpose of inducing sales by others and thus negates the existence of an intent to defraud or deceive those who may have sold their stock at an allegedly depressed price.

The concurring opinion frankly recognized that the court was reading *scienter* out of a criminal statute. It explained what the court was doing by reference to "public welfare offenses" as defined in *Morissette* v. *United States,* 342 U.S. 246 (1952). But *Morissette* only shows the error of the decision below, for there the

[3] The court below thought that "precedents established in civil cases interpreting Rule 10b-5 are applicable in criminal prosecutions under the Rule, as here." (38a.) Certainly the restrictions on use of the rule in civil cases apply at least as strongly in a criminal prosecution. But there is good reason to think that an even more restrictive approach must be taken in a criminal case than in a civil action. *See SEC* v. *Capital Gains Research Bureau,* 375 U.S. 180, 183 n. 40 (1963).

defendant was convicted of stealing government property on the basis of an instruction that "[t]he question on intent is whether or not he intended to take the property" (342 U.S. at 249), and this Court reversed because the proper question was whether the defendant intended to steal. (*Id.* at 276.) The Court distinguished cases of relatively minor offenses, punishable by a fine, in which a statute proscribes a particular result, as for example, the selling of adulterated milk, without regard to whether the result caused or was intended to cause direct injury to person or property. (342 U.S. at 252, 256.) A violation of the Exchange Act is not a minor crime. It is a felony. Besides, this Court held in *Hochfelder* that *scienter* was an essential element of Rule 10b-5, and thus "public welfare offenses" have as little relevance to determining whether this indictment charges a crime as they do as justification for applying in this case some lesser constitutional standard other than that applicable to other serious crimes.

The treatment of *scienter* by the Court of Appeals requires review by this Court to settle once and for all whether a specific intent to deceive or defraud is required under Rule 10b-5. A recent memorandum from the SEC General Counsel to staff attorneys illustrates the practical consequences that would follow if this Court's holding in *Hochfelder* were eroded in the manner reflected in the decision of the Court of Appeals.[4] The SEC memorandum advises staff attorneys to avoid allegations of *scienter* in future pleadings except in cases where the staff has evidence that would support the allegations required by this Court. (BNA, Sec. Reg. L. Rep. No. 354 at F-3 (May 26, 1976).) This tactic,

[4] The memorandum was published by the Bureau of National Affairs, Sec. Reg. L. Rep. No. 354 at F-1 (May 26, 1976).

says the SEC General Counsel, "will provide the staff with flexibility in proving its case." (*Id.*)

The lower courts should not be burdened with time-consuming "flexibility of proof" under pleadings calculated to find a form of words that circumvents this Court's requirement of an allegation of intent to deceive. There is no room in *Hochfelder,* particularly as applied to a criminal prosecution, for the kind of "flexibility" sought by the SEC memorandum and reflected in the decision of the Court of Appeals. There is an urgent need that this Court make clear that the decision in *Hochfelder* may not be circumvented by artful pleading or sophistic distinctions that cloak the absence of an essential element of a statutory offense.

D. The Use of Rule 10b-5 to Supply a Missing Element: The Creation of a Crime by Judicial Fiat

Until this case, no court has held that market manipulation in violation of the Exchange Act may be accomplished by selling stock on a national exchange in accordance with the rules of the Commission and the Exchange, in real, not fictitious, sales and without any deceptive practice.

According to the Court of Appeals, the conduct at issue is "certain guarantees against trading losses." (28a.) But neither the court nor the government ever questioned the soundness of the government's admission in the District Court that a guarantee against loss on the sale of stock is perfectly lawful in itself. (5a) Indeed, the Court of Appeals recognized that if the sales had the "incidental effect" of depressing the market price of the stock, the guarantees would retain their lawful character. (44a.)

The only identification of what the Court of Appeals regards as distinguishing the lawful from the unlawful is its statement that

> * * * the appellees are not charged with trading activities which had the effect of changing market prices (as might any large scale transactions). Rather, appellees are charged with deliberately depressing market prices—a different matter entirely from incidentally depressing prices through trading activities. [44a.]

Why it is a different matter the court below never explains. Deliberately depressing market prices, instead of incidentally depressing market prices, is a crime because the court says it is.

The conclusion is startling. Suppose that a rich man who fervently believes that all men are created equal owns a sizable bloc of stock in a corporation that has large interests in South Africa. Suppose that because of his opposition to apartheid he sells this stock with every intention in the world of depressing the price of the stock and thus convincing the Board of Directors of the corporation to stop doing business in South Africa. Suppose he goes further and persuades his friends to sell stock for the same purpose, guaranteeing them against loss. According to the opinion of the court below, he has committed a crime, not because the statute says so but because the court says so. Petitioner here, who never sold any Air West stock, can be convicted under like instructions to the jury.

This conclusion that selling stock for the purpose of depressing the price is a crime becomes even more startling if one looks at the legislative history of the Exchange Act. The court below purported to use legislative

history as a guide but ignored the most important part of that history. The original bills considered by the House and Senate *did* proscribe trades on a national securities exchange "when they are made for the purpose of raising or depressing the market price." H. Rep. No. 1383, 73d Cong., 2d Sess. 18 (1934); S. Rep. No. 792, 73d Cong., 2d Sess. 17 (1934). But after an industry representative pointed out that this provision gave "no means by which the average citizen can tell when he is going to fall within the scope of the criminal provision or not,"[5] the bill was amended to provide that the statute could not be violated unless the transaction was entered into "for the purpose of inducing the purchase or sale of such security by others." Now the provision that Congress rejected has become the head and cornerstone of a new crime created not by Congress or even by Commission rule, but by the court below.

There is no warrant in the language of the statute or the rule that permits this remarkable result. The court's statement that clauses (a) and (c) of Rule 10b-5 prohibit "manipulative activities *per se*" overlooks that these clauses do no such thing and overlooks to boot that Rule 10b-5 is a proscription against fraud. *Marsh* v. *Armada Corporation, supra,* 533 F.2d at 983.

Where is the fraud? According to the court it is in "the manipulation." What is a "manipulation"? The court gives no answer.

How could there be a manipulation when stock is sold in real transactions in accordance with the rules

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[5] *Hearings on S. Res. 84 (72d Cong.) and S. Res. 56 and S. Res. 97 Before the Senate Banking and Currency Committee,* 73d Cong. 6510 (1934).

and regulations both of the Commission and the Exchange? The court is silent.

There is no need for these mysteries. In *Ernst & Ernst* v. *Hochfelder,* 96 S.Ct. at 1384, this Court pointed out that manipulation "is and was virtually a term of art when used in connection with securities markets", quoting the dictionary definition of "manipulate" as follows:

> "To force [prices] up or down, as by matched orders, wash sales, fictitious reports * * *; to rig." [*Id.* at n. 21.]

To manipulate is thus not to force prices up or down, but to do so by particular means that are deceptive. That is why Section 9(a)(2) of the Exchange Act does not make it unlawful to raise or depress the price but requires that stock be sold for a particular unlawful purpose and in a manner calculated to achieve the purpose. The Court of Appeals committed fundamental error when it asserted that it is a criminal manipulation to depress the price, however deliberately, without regard to the means by which the depression in price is accomplished.

As applied to sales of stock, the term of art, "manipulation", proscribes a particular manner or means of selling, not the motive of the seller. Each of the particular means referred to in the definition quoted in *Hochfelder* is manipulative not because it raises or depresses price, but because of the way in which it does so. All three means give the appearance that a sale has taken place when, in fact, it has not. But here the government has conceded that the sales of stock involved were

true sales to independent buyers. (26a.) Unlike wash sales and matched orders, the sales were not artificial.[6]

Nor is anything alleged in the indictment or stated in the Court of Appeals opinion that would permit the conclusion that the sales were made in a deceptive or artificial manner. It is not contended that the stock was offered for sale at any price other than that at which independent buyers were offering to buy. Nor is it claimed that there was any collusion among brokers or that the sales were made in any manner other than that in which sales are ordinarily made on the Exchange.

As with the postulated sales for the purpose of inducing the directors of a corporation to change their mind about doing business in South Africa, the sales alleged in this indictment may have depressed the price and may be assumed, for purposes of argument, to have been intended to do so. But they were true sales, lawfully executed. There is no statute or regulation that makes such sales unlawful.

The Court of Appeals in effect concedes as much, but asserts that the judicial function in construing Rule 10b-5 is to outlaw whatever "effects" the court regards as contravening the underlying purpose of the securi-

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[6] The true sales of stock involved here are also fundamentally different from the transaction involved in *Crane Co.* v. *Westinghouse Air Brake Co.*, 419 F.2d 787 (2d Cir. 1969), *cert. denied*, 400 U.S. 822 (1970), relied on by the Court of Appeals. In *Crane* an apparent purchaser of stock on the market was financing its purchases with the proceeds of secret sales of the same stock off the market, and thus did not actually acquire ownership of the stock apparently purchased. Here, it is conceded that the sellers divested themselves of ownership of the stock they in fact sold. Therefore, these were true sales, not as in *Crane* sham purchases and sales.

ties laws, without regard to the terms of the Rule or of related and interdependent provisions of the Exchange Act. As shown above, this assertion is directly contrary to the principles of construction this Court articulated and applied in the *Hochfelder* case.

The ignoring of the Court's teaching in *Hochfelder* is the source of the complete confusion as to the application of Rule 10b-5 that the opinion of the Court of Appeals will necessarily engender in bench, bar, and citizenry.

E. The Creation of a Crime by Judicial Fiat: A Denial of Constitutional Rights

By departing from the principles set forth in *Hochfelder,* the Court of Appeals unnecessarily created the concerns candidly expressed in Judge Sneed's concurring opinion. If this were a civil action, then the decision below would represent only a departure from principles that this Court has established. But the decision was rendered in a criminal proceeding and results in the deprivation of fundamental rights.

Due process mandates that no person shall be held criminally responsible for conduct which he could not reasonably understand to be proscribed. *Jordan* v. *DeGeorge,* 341 U.S. 233 (1951). Here, as the concurring opinion below concedes, the court found a criminal violation in conduct "never heretofore branded improper by judicial decision, Commission rule or determination, or explicit Congressional act." (55a.)

Due process mandates that a criminal statute must provide some reasonable standard of guilt. Here the only standard is the court's perception of a generalized purpose. Gone are the requirements "to give adequate

guidance to those who would be law-abiding, to advise defendants of the nature of the offense with which they are charged, [and] to guide courts in trying those who are accused." *Musser* v. *Utah,* 333 U.S. 95, 97 (1948).

Due process mandates that a crime be created by Congress, not by an appellate court's use of a claimed residual power to declare conduct unlawful through an "expansive" reading of a "catch-all" regulation. *United States* v. *Bass, supra,* 404 U.S. at 348.

Due process mandates that one charged with a crime know what are the elements of the crime so that he can prepare his defense. Even today petitioner can have no firm idea of what the government claims he did that was unlawful. The court below, having created a new crime, never defines it.[7]

---

[7] The confusion engendered by the opinion of the Court of Appeals as to the application of Rule 10b-5 is nowhere more apparent than in its discussion of a purported violation consisting of a failure of disclosure. (44a-45a.) This discussion appears in a section of the court's opinion entitled "Validity of the Indictment", which follows the section entitled "Rule 10b-5 and Market Manipulation". The court states that "our reading of Counts I and II persuade [sic] us" that the indictment does allege a failure to disclose. The fact is that there is no allegation whatsoever in the indictment that the defendants failed to disclose anything to anyone.

Proceeding on the unsupported factual premise that the indictment alleges a failure to disclose, the Court of Appeals says that the expression of an opinion that the price of Air West stock would decline "without revealing that the decline was not due to the free operation of market forces" is a violation of Rule 10b-5.

The Court of Appeals appears to be creating a new duty of affirmative disclosure—without indicating to whom, when, and in what manner the disclosure must be made—whenever anyone engages in conduct that could affect the market price of a security. Whatever the propriety of creating such a duty on the basis of an indictment that does not allege the breach of any duty of disclosure, the imposition of this duty is flatly contrary to this Court's

The Fifth Amendment requires indictment by a grand jury. The decision of the court makes meaningless this "basic guarantee of individual liberty", *United States* v. *Mandujano,* 96 S.Ct. 1768, 1774 (1976), as well as the correlative Sixth Amendment right of a defendant to know the nature of the accusation against him. *See Russell* v. *United States,* 369 U.S. 749 (1962). The grand jury that indicted petitioner could not possibly have understood the elements of the crime for which it indicted him—and certainly the District Court could not find them—since those elements were ultimately found in the appellate court's perception of a general statutory purpose.

No wonder Judge Sneed warned that, on the basis of the court's opinion, the decision to prosecute or not to prosecute "is likely to be one in keeping with the political realities within which [the prosecutor] functions." Judge Sneed termed this part of the price that "this type of statute compels us to pay". But it is the decision of the court, not the statute, that would exact this price—a price that, we submit, is too high in terms of basic rights to be permissible.

---

holding in *TSC Industries, Inc.* v. *Northway, Inc.*, 96 S.Ct. 2126 (1976).

CONCLUSION

For the reasons stated herein, this writ should be granted and the judgment of the Court of Appeals for the Ninth Circuit reversed.

Respectfully submitted,

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Supreme Court, U. S.
FILED
SEP 3 1976
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-337

CHESTER C. DAVIS, *Petitioner,*

v.

UNITED STATES OF AMERICA, *Respondent.*

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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APPENDIX

CONSTITUTIONAL PROVISIONS, STATUTES, AND REGULATIONS INVOLVED

The Constitution of the United States:

AMENDMENT V

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

AMENDMENT VI

In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial, by an impartial jury of the State and district wherein the crime shall have been committed, which district shall have been previously ascertained by law, and to be informed of the nature and cause of the accusation; to be confronted with the witnesses against him; to have compulsory process for obtaining witnesses in his favor, and to have the Assistance of Counsel for his defence.

United States Code, Title 15:

§ 78i. Manipulation of security prices.

(a) It shall be unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any facility

of any national securities exchange, or for any member of a national securities exchange—

(1) For the purpose of creating a false or misleading appearance of active trading in any security registered on a national securities exchange, or a false or misleading appearance with respect to the market for any such security, (A) to effect any transaction in such security which involves no change in the beneficial ownership thereof, or (B) to enter an order or orders for the purchase of such security with the knowledge that an order or orders of substantially the same size, at substantially the same time, and at substantially the same price, for the sale of any such security, has been or will be entered by or for the same or different parties, or (C) to enter any order or orders for the sale of any such security with the knowledge that an order or orders of substantially the same size, at substantially the same time, and at substantially the same price, for the purchase of such security, has been or will be entered by or for the same or different parties.

(2) To effect, alone or with one or more other persons, a series of transactions in any security registered on a national securities exchange creating actual or apparent active trading in such security or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others.

* * *

§ 78j. Manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Code of Federal Regulations, Title 17:

§ 240.10b-5. Employment of manipulative and deceptive devices,

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEVADA

HONORABLE BRUCE R. THOMPSON, JUDGE

UNITED STATES OF AMERICA, *Plaintiff*

v.

HOWARD HUGHES, DAVID B. CHARNAY, CHESTER C. DAVIS, ROBERT A. MAHEU, JAMES H. NAIL, *Defendants*

No. LV-2843-BRT

Motions To Dismiss Indictments

Reno, Nevada, Wednesday, January 30, 1974, 9:30 o'clock A.M.

APPEARANCES:

For the Plaintiff:

V. DEVOE HEATON, ESQ.,
United States Attorney,

LAWRENCE J. SEMENZA, ESQ.,
Assistant United States Attorney,

PAUL S. GOLDMAN, ESQ.,
Assistant United States Attorney,

DEAN VERNON, ESQ.,
Assistant United States Attorney,
United States Courthouse,
300 Booth Street,
Reno, Nevada 89502

• • •

The Court: Are there any facts that indicate those are crimes?

Mr. Heaton [United States Attorney]: Excuse me, your Honor?

The Court: Are there any facts that indicate those are crimes? What if Hank Greenspun did sell his stock?

Mr. Heaton: Your Honor, in response to that, every act that has been done here, that has been spoken of here, could have been performed lawfully. But that is not the contention, obviously. It is no crime for Mr. Greenspun or Mr. Crockett or Mr. Charnay to sell stock. But if that stock is sold under a promise that they would be reimbursed for any loss, and to sell it on a certain day, in other words to dump a certain number of shares on the market on a certain day, with a promise that they would be reimbursed for any loss that they took, and this for the purpose of coercing the directors in order to change their mind, change their position, then what otherwise might be a very legitimate, lawful and innocent act, can carry criminal consequences.

The Court: What Federal statute does that violate?

• • •

The Court: And I think it should be said that in all my experience, this is the worst criminal pleading I have ever encountered.

• • •

[U. S. District Court
District of Nevada
Filed
July 30, 1974
John A. Porter, *Clerk*]

V. DeVoe Heaton
United States Attorney
300 Las Vegas Boulevard South
Las Vegas, Nevada 89101
385-6336

UNITED STATES DISTRICT COURT
DISTRICT OF NEVADA

Criminal LV 74-129

United States of America, *Plaintiff*,

v.

David B. Charnay, Chester C. Davis, Howard R. Hughes, and Robert A. Maheu, *Defendants*.

INDICTMENT for violation of Title 18, United States Code, Sections 371, 1343 and 2; Title 15, United States Code, Sections 78j(b) and 78ff (Conspiracy; stock manipulation; wire fraud; aiding and abetting)

The Grand Jury Charges:

Count I

1. From on or about July 1, 1968, up to and including the date of this indictment, the defendant Howard R. Hughes was the sole stockholder and the managing agent responsible for, and controlling the operation of, the Hughes Tool Company (now known as Summa Corporation), a Delaware corporation (hereinafter referred to as "Hughes Tool").

2. The defendant Chester C. Davis, from on or about July 1, 1968, up to and including the date of this indictment, was an attorney who acted as counsel for Hughes Tool.

3. The defendant Robert A. Maheu, from on or about July, 1968, up to and including December, 1970, was chief executive officer of Hughes/Nevada Operations (hereinafter referred to as Hughes/Nevada) which was controlled by defendant Howard R. Hughes and Hughes Tool.

4. The defendant David B. Charnay, from on or about July 1, 1968, up to and including August, 1969, was authorized to purchase and sell securities on behalf of Continental General, Inc., a private corporation in which defendant David B. Charnay was a principal stockholder.

5. Herman "Hank" Greenspun (hereinafter referred to as "Greenspun"), named herein as a co-conspirator but not as a defendant, from on or about July 1, 1968, up to and including April, 1970, was the owner and publisher of the Las Vegas Sun, a newspaper of general circulation in Las Vegas, Nevada. On or about December 31, 1968, Greenspun owned or controlled approximately 15,000 shares of common stock of Air West, Inc. (hereinafter referred to as "Air West").

6. George Crockett (hereinafter referred to as "Crockett") named herein as a co-conspirator but not as a defendant, had various dealings with Hughes Tool in 1968 and 1969. On or about December 31, 1968, Crockett owned or controlled approximately 12,000 shares of Air West common stock.

7. From on or about July, 1968, up to and including March, 1970, Air West was a corporation organized under Delaware law whose common stock was registered and traded on the American Stock Exchange (hereinafter referred to as "the AMEX"), a national securities exchange as defined in Section 3(a)(1) of the Securities Exchange Act of 1934, Title 15, United States Code, Section 78c (a)(1).

8. On or about August, 1968, defendant Howard R. Hughes did instruct defendants Robert A. Maheu and

CHESTER C. DAVIS to make an offer on behalf of Hughes Tool to acquire the assets of Air West for cash at a price allegedly designed to yield the stockholders of Air West approximately $22.00 per share.

9. On or about August 12, 1968, the Hughes Tool proposal was publicly announced.

10. On or about December 28, 1968, at a special meeting of the stockholders of Air West called by the Board of Directors of that corporation to consider and act upon the Hughes Tool proposal, Air West stockholders voted to authorize the acceptance of the Hughes Tool proposal by an approximate majority of 52%. On December 28, 1968, the members of the Board of Directors of Air West voted to reject the Hughes Tool proposal by a vote of thirteen to eleven.

11. From on or about December 28, 1968, to on or about December 31, 1968, in the District of Nevada and elsewhere, HOWARD R. HUGHES, DAVID B. CHARNAY, CHESTER C. DAVIS and ROBERT A. MAHEU (hereinafter referred to as the defendants) and George Crockett and Herman Greenspun, named herein as co-conspirators but not as defendants, and others to the Grand Jury known and unknown, unlawfully, wilfully and knowingly did combine, conspire, confederate and agree together and with each other to commit certain offenses against the United States, to wit: to violate Title 15, United States Code, Sections 78j(b), 78ff and Rule 10b-5 (17 Code of Federal Regulations, Section 240.10b-5), promulgated thereunder by the United States Securities and Exchange Commission and Title 18, United States Code, Section 1343.

12. It was part of the conspiracy that the defendants and co-conspirators, unlawfully, wilfully and knowingly, directly and indirectly, in connection with the purchase and sale of Air West securities, by the use of the means and instrumentalities of interstate commerce and by the use of

the mails and of the facilities of a national securities exchange, would use and employ manipulative and deceptive devices and contrivances, in contravention of 15 U.S.C. 78j(b), 78ff and Rule 10b-5 (17 Code of Federal Regulations, Section 240.10b-5), a rule promulgated thereunder by the United States Securities and Exchange Commission as necessary and appropriate in the public interest and for the protection of investors.

13. It was a part of the conspiracy that the defendants and co-conspirators, would unlawfully, wilfully and knowingly transmit and cause to be transmitted in interstate commerce by means of wire communications certain writings, signs, signals and sounds for the purpose of executing a scheme and artifice to defraud whereby the defendants would acquire for the Hughes Tool Company the assets of Air West by fraudulently attempting to induce and inducing the directors of Air West, who had voted against the Hughes Tool Company proposal, to change their votes and accept the proposal before it was due to expire on midnight December 31, 1968, thereby depriving the directors and shareholders of Air West of their right to have the business of Air West, that is, the consideration and decision concerning the acceptance of the Hughes Tool Company proposal as well as other offers, conducted impartially, unimpaired, unhampered and free from improper and undue influence, deceit, craft, trickery and fraud, in violation of Section 1343, Title 18, United States Code.

14. Among the means by which the defendants and co-conspirators would carry out the conspiracy were the following:

a. Defendants HOWARD R. HUGHES, CHESTER C. DAVIS and ROBERT A. MAHEU would represent to stockholders of Air West and others that if the Hughes Tool proposal was not accepted by Air West, the price of the common stock of Air West would decline substantially.

b. Defendants HOWARD R. HUGHES, CHESTER C. DAVIS, ROBERT A. MAHEU and DAVID B. CHARNAY, aided by co-conspirators Greenspun and Crockett, would manipulate and cause a decline in the market price of Air West common stock on the AMEX in the following manner:

(1) Defendants HOWARD R. HUGHES, CHESTER C. DAVIS and ROBERT A. MAHEU entered into an agreement on December 31, 1968, with defendant DAVID B. CHARNAY whereby defendant CHARNAY would sell Air West stock "short" on the AMEX and the defendants HOWARD R. HUGHES, CHESTER C. DAVIS and ROBERT A. MAHEU would pay and cause to pay the defendant CHARNAY for his assistance and reimburse him for any losses he might sustain for his "short" sales.

(2) Defendants HOWARD R. HUGHES, CHESTER C. DAVIS and ROBERT A. MAHEU would enter into agreements on or about December 31, 1968, with co-conspirators Greenspun and Crockett whereby said co-conspirators would sell their Air West stock on the AMEX and defendants HOWARD R. HUGHES, CHESTER C. DAVIS and ROBERT A. MAHEU would pay and cause to pay them for their assistance and would assure them $22 per share for selling their Air West stock regardless of the price they would receive for selling such stock on December 31, 1968.

c. As a result of their manipulative activities, defendants HOWARD R. HUGHES, CHESTER C. DAVIS, ROBERT A. MAHEU and DAVID B. CHARNAY and co-conspirators Greenspun and Crockett, among other things: (1) caused and contributed to the decline in the market price of Air West common stock on the AMEX on December 31, 1968, from an opening price of $18.00 per share to a price of $15.75 per share as of the same day, and (2) caused the Air West stockholders who sold their stock in the declining market to receive the proceeds from their sales at artificially depressed prices.

d. On or about December 31, 1968, defendants HOWARD R. HUGHES, CHESTER C. DAVIS and ROBERT A. MAHEU would cause telegrams to be sent to Air West directors who had voted against the Hughes Tool proposal urging them to change their vote to a vote in favor of accepting that proposal and threatening said directors with lawsuits in the event they did not do so.

e. For the purpose of coercing the Air West directors who had voted against the Hughes proposal to change their votes, defendants HOWARD R. HUGHES, CHESTER C. DAVIS and ROBERT A. MAHEU, on or about December 31, 1968, would cause lawsuits seeking damages to be filed by Air West shareholders and directors against the Air West directors who had voted against the Hughes Tool proposal alleging, among other things, that these directors had breached their obligations to the Air West shareholders by refusing to accept the Hughes Tool proposal and further would cause court orders to be entered against these same directors, ordering that the Air West common stock of said directors be seized and held by the court.

OVERT ACTS

In furtherance of said conspiracy and to effect the objects thereof, the defendants and their co-conspirators committed and caused to be committed the following overt acts, among others, in the District of Nevada and elsewhere:

a. On or about December 28, 1968, defendants ROBERT A. MAHEU and CHESTER C. DAVIS in San Francisco, California, had an interstate telephone conversation with co-conspirator Greenspun in Las Vegas, Nevada.

b. On or about December 29, 1968, defendant ROBERT A. MAHEU had a telephone conversation in Las Vegas, Nevada, with co-conspirator Crockett.

c. On or about December 29, 1968, defendant CHESTER C. DAVIS had a conversation in Las Vegas, Nevada, with an attorney from Wilmington, Delaware.

d. On or about December 30, 1968, defendant ROBERT A. MAHEU caused a list of Air West directors who had voted against the Hughes Tool proposal to be delivered to co-conspirator George Crockett in Las Vegas, Nevada.

e. On or about December 31, 1968, the defendants caused co-conspirator Herman Greenspun in Las Vegas, Nevada, to place an order to sell 15,000 shares of Air West stock.

f. On or about December 31, 1968, defendants HOWARD R. HUGHES and ROBERT A. MAHEU caused co-conspirator George Crockett in Las Vegas, Nevada, to send interstate telegrams to directors of Air West who had voted against the Hughes proposal.

g. On or about December 31, 1968, the defendants caused co-conspirator George Crockett in Las Vegas, Nevada, to place an order to sell 12,000 shares of Air West stock on the AMEX.

h. On or about December 31, 1968, defendants ROBERT A. MAHEU, CHESTER C. DAVIS and DAVID B. CHARNAY met at defendant MAHEU's home in Las Vegas, Nevada.

i. On or about December 31, 1968, defendant DAVID B. CHARNAY, in Las Vegas, Nevada, placed orders by interstate telephone with a securities salesman in New York, New York, to sell "short" approximately 59,100 shares of Air West stock of which 19,100 shares were sold "short" on the AMEX.

j. On or about December 31, 1968, the defendants caused representatives of Hughes Tool to enter into a contract with representatives of Air West to acquire the assets of Air West, Inc.

All in violation of Title 18, United States Code, Section 371.

COUNT II

(15 U.S.C. 78j(b))

1. The Grand Jury realleges and incorporates by reference herein each and every allegation set forth in paragraph 1 through 10 of Count I of this indictment as though fully set forth herein.

2. From on or about December 28, 1968, to on or about December 31, 1968, in the District of Nevada, HOWARD R. HUGHES, DAVID B. CHARNAY, CHESTER C. DAVIS and ROBERT A. MAHEU defendants herein, and George Crockett and Herman Greenspun, named herein as co-conspirators but not as defendants, did unlawfully, wilfully and knowingly, in connection with the purchase and sale of securities, to wit, the common stock of Air West, directly and indirectly, by the use of the means and instrumentalities of interstate commerce and the mails and the facilities of a national securities exchange, (a) employ a device, scheme, and artifice to defraud, (b) make untrue statements of material facts and omit to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, and (c) engage in acts, practices and courses of business which operated as a fraud and deceit upon purchasers and sellers of Air West securities.

3. The allegations contained in paragraph 14a through 14e of Count I of this indictment are realleged as though fully set forth herein as constituting and describing the means by which the defendants committed the offense charged in paragraph 2 of this count.

4. On or about December 31, 1968, in the District of Nevada, defendants HOWARD R. HUGHES, DAVID B. CHARNAY, CHESTER C. DAVIS and ROBERT A. MAHEU, did unlawfully, wilfully and knowingly use and caused to be used means and instrumentalities of interstate commerce, in connection with sale of the above said securities by causing an

interstate telephone call to be made by George Crockett from Las Vegas, Nevada, to a securities salesman in Phoenix, Arizona, for the purpose of placing an order to sell 12,000 shares of Air West common stock; all in violation of Title 15, United States Code, Sections 78j(b) and 78ff; 17 C.F.R. 240, 10b-5, and Title 18, United States Code, Section 2.

COUNT III

(18 U.S.C. 1343)

1. The Grand Jury realleges and incorporates by reference herein each and every allegation set forth in paragraphs 1 through 10 of Count I of this indictment as though fully set forth herein.

2. From on or about December 28, 1968, to on or about December 31, 1968, in the District of Nevada, HOWARD R. HUGHES, DAVID B. CHARNAY, CHESTER C. DAVIS and ROBERT A. MAHEU, defendants herein, and Herman Greenspun and George Crockett, named herein as co-conspirators but not as defendants, did devise and intend to devise a scheme and artifice to defraud the directors and stockholders of Air West, which said scheme and artifice to defraud is set forth more fully in paragraphs 13 and 14a through 14e of Count I of this indictment, all of which are incorporated by reference herein as though fully set forth herein.

3. On or about December 31, 1968, in the District of Nevada, defendants HOWARD R. HUGHES, DAVID B. CHARNAY, CHESTER C. DAVIS and ROBERT A. MAHEU, for the purpose of executing the aforesaid scheme and artifice to defraud, and attempting to do so, did transmit and cause to be transmitted in interstate commerce by means of a wire communication, that is, a telephone conversation between defendant DAVID B. CHARNAY in Las Vegas, Nevada, and a securities salesman in New York City, New York, certain signs, signals, and sounds; all in violation of Title 18, United States Code, Sections 1343 and 2.

COUNT IV

(18 U.S.C. 1343)

1. The Grand Jury realleges and incorporates by reference herein each and every allegation set forth in paragraphs 1 through 10 of Count I of this indictment as though fully set forth herein.

2. From on or about December 28, 1968, to on or about December 31, 1968, in the District of Nevada, HOWARD R. HUGHES, DAVID B. CHARNAY, CHESTER C. DAVIS and ROBERT A. MAHEU, defendants herein, and Herman Greenspun and George Crockett, named herein as co-conspirators but not as defendants, did devise and intend to devise a scheme and artifice to defraud the directors and stockholders of Air West, which said scheme and artifice to defraud is set forth more fully in paragraphs 13 and 14a through 14e of Count I of this indictment, all of which are incorporated by reference herein as though fully set forth herein.

3. On or about December 31, 1968, in the District of Nevada, defendants HOWARD R. HUGHES, DAVID B. CHARNAY, CHESTER C. DAVIS and ROBERT A. MAHEU, for the purpose of executing the aforesaid scheme and artifice to defraud, and attempting to do so, did transmit and cause to be transmitted in interstate commerce by means of a wire communication, that is, a telephone conversation between the brokerage firm of Goodbody and Company, in Las Vegas, Nevada, and the AMEX in New York, New York, certain signs, signals and sounds; all in violation of Title 18, United States Code, Sections 1343 and 2.

A TRUE BILL:

GWINN B. ARMSTRONG
Foreman of the Grand Jury

V. DEVOE HEATON
United States Attorney

IN THE UNITED STATES DISTRICT COURT
DISTRICT OF NEVADA

No. 74-129 BRT

THE UNITED STATES, *Plaintiff*,

v.

DAVID D. CHARNAY, CHESTER D. DAVIS, HOWARD R. HUGHES, and ROBERT A. MAHEU, *Defendants*.

PROCEEDINGS

Friday, October 25, 1974

10:00 o'clock a.m.

Appearances:

For the United States: V. DEVOE HEATON,
United States Attorney,
Las Vegas, Nevada.

JEREMIAH HANDY,
United States Attorney,
Western District of Nevada.

LAWRENCE J. SEMENZA,
Assistant United States Attorney,
Reno, Nevada.

* * * * * * * * * *

Mr. Handy [United States Attorney]:

It is my view in this particular case—and the authorities so hold. As a matter of fact, the Texas Gulf Sulphur case is abundantly clear that 10(b) was passed for the purpose, as it says in Texas Gulf Sulphur, in connection with the purchase or sale of any security, intended only that the device employed, whatever it might be, be of a sort that would cause a reasonable investor to rely thereon, and in connection therewith, and so relying, cause them to purchase or sell a corporation's securities.

That is the crux. In the indictment, we are directing our attention toward the sellers of Air West stock. It is alleged in both Count II, and it is also alleged in Paragraph 14-c, I believe. And that is who the fraud and deceit is being practiced upon: those people who are unaware of the activities of these defendants, at the time and place, during December of 1968. And the focus of the Court must be not on defendants or the co-conspirators that are alleged in the case and their selling of the stock, but the other sellers of Air West securities.

In the indictment, it says: To engage in acts and practices and courses of business which operated as a defraud and a deceit upon the purchasers and sellers of Air West securities.

That is the allegation. Directly following that, it goes to Paragraph 3, and it incorporates by reference 14-a through e. And in particular in 14-c—I believe I am correct on that—we are talking about the Air West stockholders.

In 14-c, we make two allegations: one, caused and contributed to the decline in the market price of Air West common stock on the AMEX on December 31st, of 1968; two, caused Air West stockholders, who sold their stock in a declining market, to receive the proceeds from the sales at artificially-depressed prices.

Now, when the defendants would make the representations as set forth in 14-a, it would be reasonably foreseeable to them that this conduct which is prohibited by 10(b)-5 would cause those other people in the marketplace to sell their stock at an artificially-depressed price. That conduct occurred. These were the means that these gentlemen used in order to acquire the assets of Air West. That is the focal point, as I see it, in this particular case.

The allegations are there. We are saying in this indictment that those people were caused to sell their stock.

We define the class, because it was Air West stockholders. We did not say who they were, but that may be properly the subject of a bill of particulars.

In my view, in this particular case, the stockholders, we have alleged that they did sell their stock at depressed prices. The lie and the deceit, the fraud being practiced, is that these gentlemen got together, made a representation in the following manner: that they would represent to the stockholders of Air West—which is all of them—and others, that, if the Hughes Tool proposal was not accepted by Air West, the price of the common stock would decline substantially.

They knew at that time. That is the allegation that is directed at a certain class of people, and at that time the following acts were done, as alleged in B1 and 2, whereby Charnay would sell short; Greenspun and Crockett would dump their shares into the open market.

They could reasonably foresee that this conduct would decline the price of stock to the detriment of the other stockholders of Air West who are not aware in any manner that this conduct was going on, and were not aware in any manner that there were any guarantees, as pleaded in this indictment, to these gentlemen that they wouldn't sustain any loss and would be made whole, and, therefore an offense has been charged.

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEVADA

Cr. No. LV-74-129 BRT

UNITED STATES OF AMERICA,
Plaintiff,

vs.

DAVID B. CHARNAY, CHESTER C. DAVIS, HOWARD R. HUGHES and ROBERT A. MAHEU,
Defendants.

Order Dismissing Indictment

This imposing Indictment, comprising more than nine pages, suffers from a fatal disease. It fails to state a public offense.

The Indictment is in four counts. Count I charges defendants Charnay, Davis, Hughes and Maheu with an unlawful conspiracy to acquire the assets of Air West, Inc. Admittedly, the overall purpose of the effort was lawful. The gravamen of the Indictment is that unlawful means were employed by agreement as part of the conspiracy in order to accomplish the ultimate objective. The unlawful means were the employment of a scheme or artifice to defraud by means of wire communication in violation of 18 U.S.C. § 1343 and the use of the mails and instrumentalities of interstate commerce and facilities of a national securities exchange in the employment of manipulative and deceptive devices in violation of 15 U.S.C. § 78b, 15 U.S.C. § 78ff, and 17 CFR § 240.10b-5.

Count II of the Indictment charges the employment of a manipulative or deceptive device or contrivance in violation of 15 U.S.C. § 78j(b).

Counts III and IV charge the use of interstate wire communications to effectuate a scheme and artifice to defraud the directors and stockholders of Air West, Inc. in violation of 18 U.S.C. § 1343.

The background facts alleged in the Indictment are that in August of 1968, defendants made an offer on behalf of Hughes Tool Company to acquire all the assets of Air West at a price which would yield to the stockholders approximately $22 per share; that on December 28, 1968, a majority of the stockholders voted to accept the offer; that on the same day, a majority of the directors voted to reject the offer; that in order to coerce the directors to change their vote, defendants would threaten the opposition directors with lawsuits, would file such lawsuits and would artificially depress the price of Air West stock on the American Stock Exchange by causing Charnay to sell 59,100 shares of Air West stock "short," by causing Herman Greenspun to sell 15,000 shares of Air West stock and by causing Crockett to sell 12,000 shares of Air West stock on the American Securities Exchange, and at the same time, guaranteeing to these sellers by secret understanding a recovery of $22 per share irrespective of the price obtained on the exchange. It is alleged that these activities caused a decline in the market price of Air West stock on December 31, 1968 from $18 per share to $15.75 per share.

The Government frankly concedes that unless these activities were unlawful under 15 U.S.C. § 78j(b), the Indictment does not allege a conspiracy to use unlawful means to acquire the assets of Air West and does not allege a scheme and artifice to defraud. The section cited provides:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> "* * *
>
> "(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance *in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.*" 15 U.S.C. § 78j(b). (Underlining added.)

In implementation of this statute, the Commission has adopted rules and regulations to which we must turn to determine what manipulative or deceptive devices or contrivances have been declared unlawful. The basic section of the regulations is section 240.10b-1 (17 CFR § 240.10b-1).

> "The term 'manipulative or deceptive device or contrivance,' as used in section 10(b) (48 Stat. 891; 15 U.S.C. 78j(b)), is hereby defined to include any act or omission to act with respect to any security exempted from the operation of section 12(a) 48 Stat. 892; 15 U.S.C. 78L(a)) pursuant to any section in this part which specifically provides that this section shall be applicable to such security. If such act or omission to act would have been unlawful under section 9(a) (48 Stat. 889; 15 U.S.C. 78i(a)), or any rule or regulation heretofore or hereafter prescribed thereunder, if done or omitted to be done with respect to a security registered on a national securities exchange, and the use of any means or instrumentality of interstate commerce or of the mails or of any facility of any national securities exchange to use or employ any such device or contrivance in connection with the purchase or sale of any such security is hereby prohibited."

The first portion of this definition of manipulative or deceptive device or contrivance incorporates section 9(a) of the Act (15 U.S.C. § 78i(a)), which provides, in pertinent part:

> "(a) It shall be unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any

facility of any national securities exchange, or for any member of a national securities exchange—

"* * *

"(2) To effect, alone or with one or more other persons, a series of transactions in any security registered on a national securities exchange creating actual or apparent active trading in such security or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others." 15 U.S.C. § 78i(a)(2).

This Indictment does not allege a violation of this statute because it does not allege that the purpose of the trading activity was "of inducing the purchase or sale of such security by others." On the contrary, the Indictment affirmatively alleges that the purpose was to persuade the opposing directors to change their votes so that the purchase by Hughes Tool Company of the assets of Air West could be consummated.

The second portion of 17 CFR § 240.10b-1 defines as an unlawful manipulative or deceptive device or contrivance an act made unlawful by a specific regulation. The succeeding sections define such unlawful conduct. Some of the regulations are readily understandable to a person not versed in the operations of a national securities exchange and some are not. They do quite plainly, however, define activities engaged in to artificially manipulate the market price of securities. For example: Section 240.10b-4 proscribes the short tendering of a security by a person who does not own such security; Section 240.10b-6 proscribes certain trading activities by an issuer or underwriter; Section 240.10b-7 proscribes bidding or purchasing to peg, fix or stabilize the price of a security to facilitate an offering of such security. There are many other examples. The importance of these regulations is this: The Commission has, responsive to 15 U.S.C. § 78j(b),

undertaken to define unlawful manipulative and deceptive devices and contrivances. Nowhere in the regulations has the Commission said that it is an unlawful manipulative or deceptive device or contrivance for a person or group of persons to cause substantial blocks of a security to be sold on a national securities exchange for the purpose of artificially depressing the market price of the security and to secretly guarantee to the sellers a profit or favorable return from the sales. That, in essence, is what this Indictment charges.

The Government suggests that 17 C.F.R. § 240.10b-5 abjures such conduct. It provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

"(a) To employ any device, scheme, or artifice to defraud,

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

This section is basically the anti-fraud provision of the regulations. It does not purport to define manipulative activity. In view of the many regulations which do proscribe a variety of activities engaged in to manage or artificially fix the price of securities on a national exchange, Rule 10b-5 cannot be relied on as a definition of unlawful manipulation. The thrust of Rule 10b-5 is to abjure

fraudulent representations, false statements and half-truths in the purchase or sale of a security. *Supt. of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6 (1971). Rule 10b-5 is the Commission's definition of "deceptive" in 15 U.S.C. § 78j, not "manipulative." The instant Indictment alleges no false representation or half-truth or omission to state material facts made in connection with the purchase or sale of a security.

It is a basic tenet of criminal law that: "Penal statutes are construed narrowly to insure that no individual is convicted unless 'a fair warning (has first been) given to the world in language that the common world will understand of what the law intends to do if a certain line is passed.'" *McBoyle* v. *United States,* 283 U.S. 25 (1931). See also, *F.C.C.* v. *American Broadcasting Co.*, 347 U.S. 284 (1954).

Inasmuch as we can find no statute or regulation which renders the alleged conduct of the defendants criminal, the Indictment must be dismissed. This is not to say that the conduct alleged, if true, is not reprehensible and an abuse of the power of great wealth. It is also not to say that such activity does not expose the actors to possible civil liability. We hold only that criminal misconduct has not been alleged. Accordingly,

It Hereby Is Ordered that the Indictment returned in the action entitled above is hereby dismissed.

Dated: November 13, 1974.

/s/ Bruce R. Thompson
United States District Judge

No. 75-1222

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

United States of America, *Appellant,*

v.

David B. Charnay, Chester C. Davis, Howard R. Hughes, Robert A. Maheu, *Appellees.*

Appeal from the United States District Court
for the District of Nevada

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* * *

I. The Indictment Alleges Violations of Rule 10b-5 and the Wire Fraud Statute.

The Government urged, in its main brief, that the indictment alleges violations of Rule 10b-5 and the wire fraud statute in that (a) it alleges a market manipulation and (b) it alleges that there were misrepresentations and omissions. Defendants challenge both of these claims of violation.

A. *Market Manipulation*

By repeatedly misstating the allegations of the indictment and the arguments made in the Government's brief, defendants set up "straw-man" theories which the Government is not urging, and then, by way of challenging these self-created, non-existent theories, devote considerable effort to the task of arguing matters which are not in dispute. Thus, the defendants, after attributing to the Government the view that defendants are charged with having engaged in artificial or sham sales, argue that only actual or true sales are alleged in the indictment (Br. 16, 17, 20). But the Government did not argue that the *sales* were artificial or sham. The Government argued, as the indictment alleged, that there were "artificially depressed *prices*" (emphasis added) (R. 5; main brief, p. 8).

Defendants further characterize the allegations of the indictment and the arguments in the Government's main brief as resting on the proposition that it is an unlawful manipulation merely to guarantee others against loss on stock sales which have the effect of depressing the market price of the stock (Br. 3, * * *).

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 75-1222

UNITED STATES OF AMERICA, *Appellant*,

v.

DAVID B. CHARNAY, CHESTER C. DAVIS, HOWARD R. HUGHES, ROBERT A. MAHEU, *Appellees*.

[May 7, 1976]

Appeal from the United States District Court for the District of Nevada

Opinion

Before: BROWNING and SNEED, Circuit Judges, and JAMESON,* District Judge.

JAMESON, District Judge:

This appeal from an order dismissing the indictment presents the question of whether the indictment, alleging a market manipulation artificially depressing the market price of a security on a national securities exchange, was sufficient to charge the defendants-appellees with a conspiracy to violate, and the violation of, the antifraud provisions of Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. 78j(b) and 78ff, Rule 10-b promulgated thereunder, and the wire fraud statute, 18 U.S.C. § 1343. We conclude that the indictment was sufficient to allege a criminal offense and reverse.

Charges against Defendants-Appellees

Two indictments were returned against defendants-appellees. The first, filed December 27, 1973, alleged that conduct of Howard Hughes and his associates in taking

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* Honorable W. J. Jameson, United States District Judge for the District of Montana, sitting by designation.

over Air West, especially certain guarantees against trading losses given by Hughes, violated 15 U.S.C. §§ 78i(a)(2), 78j(b), 78n and Securities and Exchange Commission (SEC) Rule 10b-5 (manipulation of security prices, employment of manipulative devices), and 18 U.S.C. §§ 2, 3, 4, 371 and 1343 (aiding and abetting, accessory after the fact, misprision of a felony, conspiracy, and wire fraud). This indictment was dismissed on January 30, 1974, for failure to state an offense. The Government did not appeal the dismissal. A second indictment was returned on July 30, 1974 charging that the appellees' conduct in the Air West acquisition was in violation of 15 U.S.C. §§ 78j(b), 78ff and Rule 10b-5 and 18 U.S.C. §§ 2, 371, and 1343, thus omitting reference to 15 U.S.C. § 78i(a)(2) (manipulation of security prices) and 18 U.S.C. §§ 3 and 4 (accessory after the fact, misprision of a felony). The second indictment was dismissed on November 13, 1974 and is the subject of this appeal.

The defendants were identified in the indictment, for the period in question, as follows: Hughes was the sole stockholder and managing agent of Hughes Tool, a Delaware corporation. Davis was legal counsel for Hughes Tool. Maheu was chief executive officer of Hughes/Nevada Operations. Charnay was a principal stockholder of a private corporation authorized to purchase and sell stocks. Two unindicted co-conspirators were also identified: Herman Greenspun, a newspaper publisher and owner of stock in Air West, and George Crockett, an owner of Air West stock. Air West is a Delaware corporation whose stock was listed and traded on the American Stock Exchange (the AMEX).

Both indictments detailed essentially the same facts as a basis for the charges against appellees. These facts were well summarized by the district court:

> "The background facts alleged in the Indictment are that in August of 1968, defendants made an offer on

> behalf of Hughes Tool Company to acquire all the assets of Air West at a price which would yield to the stockholders approximately $22 per share; that on December 28, 1968, a majority of the stockholders voted to accept the offer; that on the same day a majority of the directors voted to reject the offer; that in order to coerce the directors to change their vote, defendants would threaten the opposition directors with lawsuits, would file such lawsuits and would artificially depress the price of Air West stock on the American Stock Exchange by causing Charnay to sell 59,100 shares of Air West stock 'short,' by causing Herman Greenspun to sell 15,000 shares of Air West stock and by causing Crockett to sell 12,000 shares of Air West stock on the American Securities Exchange, and at the same time, guaranteeing to these sellers by secret understanding a recovery of $22 per share irrespective of the price obtained on the Exchange. It is alleged that these activities caused a decline in the market price of Air West stock on December 31, 1968 from $18 per share to $15.75 per share."

The Government contends that the "aftermath" of these activities was a reversal by Air West's directors of their earlier position and a decision on December 31 to sell Air West's assets to Hughes Tool.

The Indictment

Count I

The July 30, 1974 indictment contains four counts. The first ten paragraphs of Count I identify the parties and describe their roles in the corporate takeover. Paragraphs 11 through 13 allege that (1) the defendants and the unindicted co-conspirators willfully and knowingly conspired and agreed to violate the securities laws, 15 U.S.C. §§ 78j(b), 78ff and Rule 10b-5; (2) the defendants and co-conspirators used the instrumentalities of interstate com-

merce, the mails, and the facilities of a securities exchange to conduct a manipulative scheme in contravention of the securities laws; and (3) the conspirators transmitted by wire interstate communications to induce the directors who had voted against the Hughes Tool Company proposal of Air West to change their votes, thus depriving the directors and shareholders of the right to conduct their corporation free from undue influence, deceit, and fraud, in violation of 18 U.S.C. § 1343.

Paragraph 14 describes the means by which the conspirators would carry out their plan, i.e., that the defendants Hughes, Davis and Maheu would represent that unless the Hughes Tool offer was accepted, the price of Air West stock would decline substantially; that the defendants and co-conspirators would manipulate and cause a decline in the market of Air West stock, and cause the Air West stockholders who sold their stock to receive artificially depressed prices;[1] and that the defendants Hughes, Davis and Maheu would cause telegrams to be sent to the directors of Air West threatening lawsuits if they did not change their votes. Paragraph 14 also lists ten overt acts committed in furtherance of the conspiracy, including three interstate conversations and an unspecified number of interstate telegrams, all in violation of 18 U.S.C. § 371.

Count II

The second count incorporates by reference the first ten paragraphs of Count I and alleges that the conduct described in Count I constituted violations of 15 U.S.C. §§ 78j(b), 78ff, 18 U.S.C. § 2 and Rule 10b-5, in that the defendants wilfully and knowingly employed a scheme to defraud, made untrue statements of material facts and omitted material facts necessary to make the statements made not misleading, and used instruments of interstate

[1] The indictment does not list the stockholders who sold at the depressed prices.

commerce to accomplish their scheme by placing a telephone call on December 31, 1968 to carry out their plan, all of which operated as a fraud and deceit upon purchasers and sellers of Air West stock.

Counts III and IV

Count III alleges that for the purpose of executing the scheme to defraud described in Count I, the defendants caused to be transmitted in interstate commerce telephone conversations between Charnay in Las Vegas, Nevada, and a securities salesman in New York City, and Count IV alleges telephone conversations between a brokerage firm in Las Vegas and the AMEX in New York City, all in violation of the wire fraud statute, 18 U.S.C. § 1343 and § 2, aiding and abetting.

Order Dismissing Indictment

In its order dismissing the indictment the district court noted that "the gravamen of the Indictment is that unlawful means were employed by agreement as part of the conspiracy to accomplish the ultimate objective . . ." of acquiring the assets of Air West, an obviously lawful purpose. The court recognized that "the conduct alleged, if true, is . . . reprehensible and an abuse of the power of great wealth" but felt forced to conclude that the indictment had not properly alleged a public offense. In reaching this conclusion the order reviewed each of the statutes alleged to have been violated in the various counts of the indictment.

Discussing 15 U.S.C. § 78j(b), which makes it illegal to use a manipulative or deceptive device in contravention of the SEC rules, the court considered the several 10b rules promulgated under the statute to determine whether the conduct described in the indictment could be said to be within their prohibitions. The court characterized Rule

10b-1 as the "basic section of the regulation", which it noted incorporates 15 U.S.C. § 78i(a), making illegal manipulation "for the purpose of inducing the purchase or sale of . . . securit(ies) by others." The court concluded that the indictment did not properly allege a § 78i(a)(2) violation (and thereby a Rule 10b-1 violation) since there was no allegation of a purpose to induce the purchase or sale of securities.[2]

The court found other 10b rules defined more specific manipulative activities, none of which described the de-

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[2] 15 U.S.C. § 78i(a) provides in pertinent part:

> "(a) It shall be unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any facility of any national securities exchange, or for any member of a national securities exchange—
>
> "• • •
>
> "(2) To effect, alone or with one or more other persons, a series of transactions in any security registered on a national securities exchange creating actual or apparent active trading in such security or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others."

SEC Rule 10b-1, 17 C.F.R. § 240.10b-1 states:

> "The term 'manipulative or deceptive device or contrivance,' as used in section 10(b) (48 Stat. 891; 15 U.S.C. 78j(b)), is hereby defined to include any act or omission to act with respect to any security exempted from the operation of section 12(a) 48 Stat. 892; 15 U.S.C. 781(a)) pursuant to any section in this part which specifically provides that this section shall be applicable to such security, if such act or omission to act would have been unlawful under section 9(a) (48 Stat. 889; 15 U.S.C. 78i(a)), or any rule or regulation heretofore or hereafter prescribed thereunder, if done or omitted to be done with respect to a security registered on a national securities exchange, and the use of any means or instrumentality of interstate commerce or of the mails or of any facility of any national securities exchange to use or employ any such device or contrivance in connection with the purchase or sale of any such security is hereby prohibited."

fendants, alleged conduct.[3] The court noted that Rule 10b-5 "is basically the antifraud provision of the regulations. It does not purport to define manipulative activity". A review of the regulations led the court to conclude:

> "Nowhere in the regulations has the commission said that it is an unlawful manipulative or deceptive device to cause substantial blocks of a security to be sold on a national securities exchange for the purpose of artificially depressing the market price of the security and to secretly guarantee to sellers a profit or favorable return from the sales. That, in essence, is what this Indictment charges."

Noting the Government's concession that unless the alleged conduct was proscribed by the securities law, the other statutory violations could not stand,[4] the district court held that the Government had not met its burden to properly allege the defendants' criminal misconduct in any of the counts of the indictment.

Contentions of Parties

In contending that the indictment alleges a violation of, and conspiracy to violate, Rule 10b-5 under 15 U.S.C. 78j(b), and the wire fraud statute, 18 U.S.C. § 1343, the Government argues that (1) "a manipulation of the market which interfere with the free and open interplay of supply

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[3] The court noted that Rule 10b-4 proscribes the short tendering of a security by a non-owner, Rule 10b-6 proscribes fraudulent trading activities by an issuer or underwriter, and Rule 10b-7 makes illegal bidding to peg or manipulate the market. The court found, and we agree, that none of the activities alleged to have been committed by appellees come within the conduct forbidden by these rules.

[4] The Government admits that its counsel made this concession, but contends that it was erroneous and "ignored the practice of the Government to prosecute manipulative conduct even prior to enactment of the Federal securities laws and regardless of whether a securities violation is charged", (opening Brief, p. 14, n. 3).

and demand constitutes fraud within the meaning of both Rule 10b-5 and the wire fraud statute"; and (2) the allegations in the indictment of a market manipulation were sufficient to charge an offense.

Appellees contend that the district court properly dismissed the indictment for failure to state an offense under either Rule 10b-5 or § 1343 because the "indictment does not allege facts which show any false statement or half-truth, any failure to disclose anything to anyone, any facts essential to a charge of manipulation, or any intent to deceive anyone, and the indictment does not otherwise allege facts which show how or in what manner conduct which is lawful in itself was false or fraudulent or intended to be so."[5] Appellees contend further that the indictment shows on its face that the conduct occurred beyond the five-year statute of limitations prescribed by 18 U.S.C. § 3822 and fails to plead facts which invoke 18 U.S.C. § 3288, which provides for reindictment within six months after an indictment has been dismissed.

Rule 10b-5 and Market Manipulation

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), provides that it is:

> "unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or any facility of any national securities exchange . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance

[5] As noted *supra*, the district court held in effect that Rule 10-b and the wire fraud statute proscribing fraudulent conduct did not purport to include manipulative or deceptive activity. On this appeal the appellees "do not contend that a manipulation cannot be a fraud or a part of a fraud" but contend that the indictment fails to allege facts which "state a crime of manipulation or fraud". (Appellees' Brief, p. 4).

> in contravention of such rules as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5, 17 C.F.R. § 240.10b-5, adopted by the SEC in 1942, states:

> "Employment of manipulative and deceptive devices. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase of any security."

In the first Supreme Court decision involving Rule 10b-5 and 15 U.S.C. §78j(b), *SEC* v. *National Securities, Inc.*, 393 U.S. 453 (1969), the Court observed that "§ 10(b) and Rule 10b-5 may well be the most litigated provisions in the federal securities laws . . .". 390 U.S. at 465. The Court concluded that "Section 10(b) and Rule 10b-5 together constitute one of the several broad antifraud provisions contained in the securities laws".[6] Id. at 466.

[6] The Court held that in light of the broad antifraud purposes of Section and Rule, which "apply in connection with the purchase or sale of any security", exchanges by shareholders of a corporation of their old stock for shares in a new company were "purchases" within the meaning of the statutory language. 393 U.S. 466-468.

Unfortunately for purposes of this case, there has been very little litigation concerning the application of the Rule to market manipulations in corporate takeovers, and no cases at all involving the specific conduct in which the appellees are alleged to have engaged. We therefore turn to the legislative, administrative and judicial history of the Securities Exchange Act and Rule 10b-5 in determining whether the appellees' alleged conduct, if true, constitutes an indictable offense.[7]

In Section 2 of the Securities Exchange Act, 15 U.S.C. § 78b, Congress explained that one of its primary objectives in formulating the Act was "to insure the maintenance of fair and honest markets" in transactions conducted on the securities exchanges. The House Report on the Act, H.R. Rep. No. 1383, 73rd Cong., 2d Sess., p. 10 (1934) gives further evidence of Congress' concern:

> "To insure to the multitude of investors the maintenance of fair and honest markets, manipulative practices of all kinds on national exchanges are banned. The bill seeks to give investors markets where prices may be established by the free and honest balancing of investment demand with investment supply."[8]

Senate Report No. 1455, 73rd Cong., 2d Sess., p. 81 (1934), similarly states:

> "The purpose of the Act is . . . to purge the securities exchanges of those practices which have prevented them from fulfilling their primary function of furnishing open markets for securities where supply and demand may freely meet at prices uninfluenced by manipulation or control."

[7] For the purposes of ascertaining the validity of an indictment the facts alleged by the Government are assumed to be true. *United States* v. *Howard*, 352 U.S. 212, 214-215 (1957).

[8] The same report also states on p. 11 that:

> "The idea of a free and open public market is built upon the theory that competing judgments of buyers and sellers as to the fair price of the security brings about a situation where the market price reflects as nearly as possible a just price."

The language of the section and its legislative history leave little doubt that Congress intended § 78j(b) to operate, after rule making by the SEC, as a broad prohibition against deceptive devices.[9] This manifestation of Congressional intent was recognized in *Supt. of Insurance* v. *Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971), where the Court, quoting from H.R. Rep. No. 1383, 73d Cong., 2d Sess., 7, said in part: "Since practices 'constantly vary and where practices legitimate for some purposes may be turned to illegitimate and fraudulent means, broad discretionary powers' in the regulatory agency 'have been found practically essential' . . . . Section 10(b) must be read flexibly, not technically and restrictively". In light of this background it is not surprising that the broad language of Rule 10b-5 has been applied by the courts and the SEC as the principal Rule under § 78j(b) for prohibiting the multitude of deceptive and manipulative devices which continually appear in the securities markets, including activities directed, as the conduct of the appellees is alleged to have been designed, toward the manipulation of securities prices for personal gain.

The utilization of Rule 10b-5 to reach a wide range of deceitful securities trading practices was given impetus by early cases holding that the Act and the Rule provide an implied right of private action in favor of an injured party to enforce the Rule's sanctions. See, *e.g.*, *Karden* v. *National Gypsum Co.*, 69 F.Supp. 512 (E.D. Pa. 1946).

[9] Even before the enactment of the Securities Exchange Act market manipulations seeking to create artificial prices were considered to be unlawful and contrary to public policy. See, *e.g.*, *Harper* v. *Crenshaw*, 82 F.2d 845 (D.C. Cir. 1936) citing early English and American cases which held that contracts for the purpose of creating fictitious securities prices were unenforceable.

This principle was affirmed by the Supreme Court in *Bankers Life & Cas. Co., supra*, 404 U.S. at 10. Much of the case law on Rule 10b-5 has, therefore, developed in civil rather than criminal litigation. In *SEC* v. *Joiner Corp.*, 320 U.S. 344, 355 (1943), the Court indicated that the primary difference between criminal and civil prosecutions under the securities laws is the burden of proof required for a verdict. As noted in *United States* v. *Clark*, 359 F.Supp. 128, 130 (S.D.N.Y. 1973), "there is no reasonable basis for holding that some different interpretation [of Rule 10b-5] should apply to a criminal action" than in a civil action. We agree that precedents established in civil cases interpreting Rule 10b-5 are applicable in criminal prosecutions under the Rule, as here.

Civil cases holding manipulative and deceitful devices violative of § 78j(b) and Rule 10b-5 include *Mutual Shares Corp.* v. *Genesco, Inc.*, 384 F.2d 540, 546-547 (2 Cir. 1967), where the court found that the statute and rule made unlawful a majority stockholder scheme to reduce dividends in order to force down the market price of stock and cause minority shareholders to sell out at depressed values. In reaching its conclusion the court observed that "[d]eceitful manipulation of the market price of publicly-owned stock is precisely one of the types of injuries to investors at which the Act and Rule were aimed". 384 F.2d at 547. In *Crane Co.* v. *Westinghouse Air Brake Co.*, 419 F.2d 787, 792-798 (2 Cir. 1969), the court was presented with a factual situation somewhat resembling the case before us. The court held that Rule 10b-5 was violated by the scheme of one corporation seeking a merger and attempting to block a tender offer by another corporation in which it bought large blocks of shares of the target corporation in the open market, thus driving the market price up while at the same time financing these purchases by disposing of the newly acquired stock at a loss in secret and unreported sales. The court found that these activities operated as a deceit on those in the investing public who were misled by the trading activities as well as on the other corporation whose tender offer was blocked by the scheme. Recently in *Schlick* v. *Penn-Dixie Cement Corp.*, 507 F.2d 374, 378-381 (2 Cir. 1974), the court found a market manipulation in which one party to a corporate merger allegedly caused the market price of the other corporation to increase in order to obtain a more favorable exchange ratio to be prohibited by the provisions of Rule 10b-5.

These cases are illustrative of the extent to which § 78j(b) and Rule 10b-5 have been applied to a broad range of manipulative practices.[10] As stated in *Herpich* v. *Wallace*, 430 F.2d 792, 801-802 (5 Cir. 1970):

> "[T]he Section [78j(b)] reflects the design of the Exchange Act as a means for preventing inequitable and unfair practices on securities exchanges and over-the-counter markets and for insuring fairness and honesty in securities transactions generally . . . Congress sought to protect persons 'who would be engaged in buying and selling and trading in * * * securities as broadly defined in the Act.' . . . It did not make section [78j(b)] self-executing, nor did it limit the section's application to the manipulative and deceptive devices or contrivances known in 1934. Instead, it wrote the Section as a 'catch-all' meant to reach practices employed in connection with the purchase or sale of securities which were contrary to the public interest or the interest of investors.
>
> * * *

[10] The SEC has utilized Rule 10b-5 to halt market manipulations in cases which have not reached the courts. In *Delafield & Delafield*, CCH Fed. SEC. L. Rep. ¶ 77,648 (1968), for example, the Commission issued a consent order finding a broker in violation of Rule 10b-5 for his activities in manipulating stock prices downward in order to induce a shareholder to sell his substantial holdings at a reduced price to the broker's customers.

"Together the section and the rule aim at reaching 'misleading or deceptive practices, whether or not they are precisely and technically sufficient to sustain a common law action for fraud and deceit,' . . . carried on 'in connection with' the purchase or sale of securities. They are not intended as a specification of particular acts or practices that constitute 'manipulative or deceptive devices or contrivances,' but are instead designed to encompass the infinite variety of devices that are alien to the 'climate of fair dealing,' . . ." [11]

Appellees argue that the cases applying Rule 10b-5 to market manipulations are distinguishable because the courts found either insiders with an affirmative duty to disclose due to their relationship with corporate management or defendants with a purpose to induce the purchase or sale of securities by deceit. While we recognize that none of the factual situations in the cases discussed *supra* are identical to that present here, we do not believe that the cases interpreting Rule 10b-5, or the Rule itself may be read as restrictively as appellees suggest. It is true that much of the Rule 10b-5 litigation dwells on the special duty

[11] Recent cases concerning frauds in corporate take overs have concentrated on deceitful tender offers and have utilized § 78n(e), enacted by Congress in 1968, to deal specifically with such problems after some courts had found difficulty in finding standing for individual plaintiffs to bring actions under Rule 10b-5 in tender offer cases. See, *e.g.*, *Mutual Shares Corp.* v. *Genesco, Inc.*, *supra*, 384 F.2d at 545. It is doubtful that the facts here come under § 78n(e), especially where the acts complained of commenced before the statute became effective. In a criminal prosecution, the standing problem is, of course, not present and Rule 10b-5 is applicable if the conduct charged falls within the Rule's prohibitions. We note, however, that Rule 10b-5 has been held to cover tender offer frauds despite the more specific provision of § 78n(e). See, *e.g.*, *Smallwood* v. *Pearl Brewing Co.*, 489 F.2d 579, 589-595 (5 Cir. 1974); but see *contra, H. K. Porter Co., Inc.* v. *Nicholson File Co.*, 482 F.2d 421, 425 (1 Cir. 1973). See generally, Securities Exchange Act-Tender Offers, 6 ALR Fed. 906 (1971).

of insiders to disclose information. However, the language of the Rule provides no basis for concluding that only "insiders" are subject to its requirements.[12] As noted in *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 858-862 (2 Cir. 1968), *cert. denied sub nom. Coates* v. *SEC*, 397 U.S. 976 (1969), the duty to disclose material information is based upon a potential manipulator's duty to the investing public as a whole as well as to particular shareholders. Moreover, it should be noted that clauses (a) and (c) of Rule 10b-5 are not aimed at failures to disclose. Rather they are flat prohibitions of deceitful practices and market manipulations.

Concerning the necessity of alleging and proving a purpose to induce others to trade in securities under Rule 10b-5, there is simply no requirement under the Rule, as there is under §78i(a), for such pleading or proof. Neither § 78j(b) nor the Rule make any reference to a specific intent to induce trading by others.

As the court noted in *Landy* v. *F.D.I.C.*, 486 F.2d 139, 161 (3 Cir. 1973), "A scheme deliberately calculated to manipulate the market value of a stock would be covered under the rule." Here the Government has alleged that the appellees in selling their Air West stock purposely sought to depress the market for the stock, and in fact achieved this result, with the object and effect of deceiving the shareholders and directors of Air West in Hughes' takeover attempt. Such conduct falls within the type of activity which Congress sought to prohibit in enacting the Securities Act and which Rule 10b-5 explicitly prohibits. It constitutes an indictable offense.

[12] Loss, Securities Regulations 1445 (2d Ed. 1961) observes that "Rule 10b-5, like § 17(a) of the Securities Act, is not limited to corporate insiders—however that term may be defined. The rule may be invoked whenever any person, insider or outsider, indulges in fraudulent practices, misstatements or half-truths in connection with the purchase of securities."

Validity of the Indictment

Appellees contend that even if the conduct in which they are alleged to have engaged is proscribed by the securities laws, the indictment must nevertheless fail due to numerous fatal defects in pleading. We turn now to appellees' specific challenges to the various counts.

Count I

The first count of the indictment charged the appellees with conspiring to violate the securities laws, specifically Rule 10b-5, and the wire fraud statute, 18 U.S.C. § 1343. Under 17 U.S.C. § 371, the conspiracy statute which is the basis for Count I, it is necessary to allege those three elements which are said to be the gist of the offense: the agreement, the unlawful object towards which the agreement is directed, and an overt act in furtherance of the conspiracy. *United States* v. *Falcone*, 311 U.S. 205, 210 (1940); *United States* v. *Offutt*, 127 F.2d 336, 338 (D.C. Cir. 1942); *United States* v. *Wilson*, 356 F.Supp. 463, 464 (D. Md. 1973). Count I meets these requirements. It is alleged that appellees and their unindicted co-conspirators agreed to a scheme whereby they would coerce and defraud the directors and shareholders of Air West; that the object of the conspiracy was in violation of both the securities laws and the wire fraud law; and that the appellees and their co-conspirators undertook ten overt acts in furtherance of their scheme. It is apparently appellees' position, however, that any defect in Count I occurs not in failing to properly allege a conspiracy, but in the underlying assumption that the substantive offenses charged in the remaining counts of the indictment are in fact illegal. We believe that Count I is adequate to charge a conspiracy and, as explained below, the substantive counts, upon which Count I is based, are sufficient to state an offense.

Count II

Appellees direct their attack primarily at Count II, which alleges that the conduct described in Count I violated the securities laws and the aiding and abetting statute. They contend that the count fails because it (1) does not allege that "stock was sold [by appellees] for the purpose of inducing the sale of such stock by others and in a deceitful manner designed to achieve such a purpose";[13] (2) fails to allege any failure by the appellees to disclose material facts; and (3) does not allege that appellees acted with an intent to defraud.

With respect to the argument that a market manipulation charged under Rule 10b-5 requires an allegation of the defendants' purpose to induce the sale of securities by others, as noted *supra*, we find nothing in the language of either § 78j(b), § 78ff, or Rule 10b-5 which implies this requirement. Had the Government charged appellees under § 78i(a) an allegation of a purpose to induce would have been essential. However, § 78i(a) is not a basis for any of the charges here and cannot be read as a limitation on Rule 10b-5. The legislative and judicial history of § 78j(b) make it clear that the statute and rules promulgated thereunder are to operate independently of other securities laws provisions.[14] As the court noted in *Texas Gulf Sulphur*, 401 F.2d at 859, "from its very inception, Section 10(b) [§ 78j(b)], and the proposed sections . . . from which it was derived, have always been acknowledged as catchalls" for manipulative activities which the SEC finds detrimental to the interests of investors and which are not covered by other provisions of the securities laws.

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[13] Appellees' brief, p. 13.

[14] Appellees' argument implies that § 78i(a) rather than Rule 10b-5 is the section under which market manipulations should be charged. The language of Rule 10b-5 and its history, however, undercut the validity of this argument.

Had Congress or the SEC intended that a specific purpose to induce others to trade was a requirement under § 78j(b), this requirement would have been specified, as it was in § 78i(a).[15]

Appellees' argument that Count II must fail because it does not allege any omission by appellees to disclose material facts we reject for two reasons: First, Rule 10b-5 prohibits manipulative activities *per se* and not only those activities resembling common law fraud. As we note above, clauses (a) and (c) of the Rule make no reference to a requirement that defendants charged under the rule must fail to disclose material facts for their conduct to be proscribed. That conduct is covered by clause (b). Second, our reading of Counts I and II persuade us that the indictment does adequately allege material misrepresentations and omissions. The description of appellees' activities in representing to Air West stockholders and directors that the market would decline if the Hughes tender offer were rejected and their subsequent conduct in driving down the market price without revealing that the decline was not due to the free operation of market forces constitutes a sufficient allegation of a misrepresentation and omission.[16] As the court observed in *O'Neill* v. *Maytag*,

[15] Appellees, quoting from a 1941 opinion of the Commission's General Counsel, 2 CCH Fed. Sec. L. Rep. ¶ 22,565, point out that the SEC has indicated that the Exchange Act does not prohibit trading activity which may advance or depress the market. It may be noted first that this opinion was issued before the adoption of Rule 10b-5. In any event, the appellees are not charged with trading activities which had the effect of changing market prices (as might any large scale transactions). Rather, appellees are charged with deliberately depressing market prices—a different matter entirely from incidentally depressing prices through trading activities.

[16] The indictment states in Count I, para. 14:

"(a) Defendants Howard R. Hughes, Chester C. Davis, and Robert A Maheu would represent to stockholders of Air West and others that if the Hughes Tool proposal was not accepted by Air West, the price of the common stock of Air West would decline substantially,

"(b) Defendants Howard R. Hughes, Chester C. Davis, Robert A. Maheu, and David B. Charnay, aided by co-conspirators Greenspun and Crockett, would manipulate and cause a decline in the market price of Air West common stock on the AMEX in the following manner: . . ."

339 F.2d 764, 768 (2 Cir. 1964) (quoted with approval in *Mutual Shares Corp.* v. *Genesco Inc., supra,* 384 F.2d at 546), "deception may take the place of verbal acts."[17] Failure to disclose that market prices are being artificially depressed operates as a deceit on the market place and is an omission of a material fact.

Nor do we find merit in appellees' contention that the indictment is fatally defective because it fails to allege specific intent to defraud. In construing §§ 78j(b) and 78ff in *United States* v. *Pelz,* 433 F.2d 48, 54 (2 Cir. 1970), Judge Friendly says in part: "The language makes one point entirely clear. A person can willfully violate an SEC rule even if he does not know of its existence. This conclusion follows from the difference between the standard for violation of the statute or a rule or regulation, to wit "willfully", and that for false or misleading statements, namely "willfully and knowingly". In considering "what mental state" must be proved Judge Friendly refers to an article by Judge Herlands in 21 Va.L.Rev., and continues at 433 F.2d at 55:

> "The Herlands article concluded it was necessary only that 'the prosecution establishes a realization on the defendant's part that he was doing a wrongful act,' 21 Va.L.Rev. at 149. We accept this with the qualifica-

[17] The court continued: "And it need not be deception in any restricted common law sense; one of the central purposes of federal securities legislation would otherwise be seriously vitiated". The court recognized, however, that "there must be allegation of facts amounting to deception in one form or another; conclusory allegations of deception or fraud will not suffice". 339 F.2d at 768.

> tions, doubtless intended by the author, that the act be wrongful under the securities laws and that the knowingly wrongful act involve a signi..cant risk of effecting the violation that has occurred." [18]

The indictment was sufficient to meet these tests. It alleges a knowing participation by all of the defendants in the perpetration of the manipulation which created the artificially depressed market price and consequent fraud and deceit. It was sufficient to allege a violation of § 78j(b) and Rule 10-b.[19]

Counts III and IV

With respect to Counts III and IV charging violation of the wire fraud statute, 18 U.S.C. § 1343,[20] appellees con-

[18] See also *United States* v. *Dardi*, 330 F.2d 316, 331 (2 Cir. 1964) and Securities Laws—Scienter, 20 ALR Fed. 227 (1974). The ALR article notes one case, *United States* v. *Van de Carr*, CCIT Fed Sec. L.Rep. ¶ 93481 (C.D. Cal. 1972), which appears to reach a contrary result. The authority of *Van de Carr*, however, is questionable since it was concerned with violations of Federal Reserve Board regulations rather than SEC rules.

[19] *United States* v. *Piepgrass*, 425 F.2d 194 (9 Cir. 1970) cited by appellees is distinguishable. It did not specifically consider the question presented in this case and involved a prosecution under 15 U.S.C. § 77q(a). The court did recognize that, "Intent to defraud may be inferred from one's knowledge that the scheme operated in a deceitful manner", but held that "the latter knowledge must be possessed by each individual". 425 F.2d at 199. It was so alleged in this case.

[20] § 1343 provides in pertinent part:

> "Fraud by wire, radio or television
>
> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire . . . communication in interstate . . . commerce, any writing, signs, signals, . . . or sounds for the purpose of executing such scheme or artifice, shall be fined not more than $1,000 or imprisoned not more than five years, or both."

tend that the Government has failed to allege adequate facts to show the nature of the fraud and how it was to be accomplished. We agree with the general principle relied on by appellees that an indictment under the wire fraud statute must "set out clearly what the artifice was wherein the fraud consisted, and how it was to be accomplished". *Etheredge* v. *United States*, 186 F. 434, 437 (4 Cir. 1911). We conclude, however, that the facts alleged in the indictment were sufficient to meet this requirement.

Count I, which is incorporated by reference into Counts III and IV, describes in some detail the operation of the allegedly manipulative scheme and its purpose. Counts III and IV state that the object of this activity was to defraud the shareholders and directors of Air West. Count I gives the approximate dates during which the scheme was in effect. Counts III and IV give the specific dates on which appellees are alleged to have used interstate wire facilities to accomplish their objective. The counts charging appellees with wire fraud appear to be sufficiently specific under the standards cited by appellees.

In *Hagner* v. *United States*, 285 U.S. 427, 431 (1932), the Supreme Court stated:

> "The true test of the sufficiency of an indictment is not whether it could have been made more definite and certain, but whether it contains the elements of the offense intended to be charged, 'and sufficiently apprises the defendant of what he must be prepared to meet, and, in case any other proceedings are taken against him for a similar offense, whether the record shows with accuracy to what extent he may plead a former acquittal or conviction.' [citations omitted]" [21]

We conclude that each count of the indictment meets this test. If the defendants desire more definite info..mation, they may obtain it through a bill of particulars.

[21] Accord, *United States* v. *Debrow*, 346 U.S. 374, 376 (1953).

Statute of Limitations

18 U.S.C. § 3282 provides that no person shall be prosecuted for any offense, not capital, "unless the indictment is found or the information is instituted within five years after such offense shall have been committed". The first indictment against appellees was returned on December 27, 1973, within five years after December 31, 1968, the final date of the manipulation alleged in the indictment. The first indictment was dismissed on January 30, 1974, and the second indictment was returned on July 30, 1974, after the five year period had elapsed. Obviously the action would be barred, except for 18 U.S.C. § 3288, which provides that "a new indictment may be returned . . . within six calendar months of the date of the dismissal of the indictment or information . . ." [22]

Appellees contend, however, that § 3288 is inapplicable for four reasons: (1) the second indictment attempts to charge different offenses than those charged in the first, in contravention to judicial interpretations of § 3288; (2) § 3288 cannot apply to the conspiracy count of the first indictment because that count was dismissed before the statute of limitations had run and not after the period, as provided in § 3288; (3) the second indictment must recite

[22] 18 U.S.C. § 3288 reads:

> "Whenever an indictment is dismissed for any error, defect, or irregularity with respect to the grand jury, or an indictment or information filed after the defendant waives in open court prosecution by indictment is found otherwise defective or insufficient for any cause, after the period prescribed by the applicable statute of limitations has expired, a new indictment may be returned in the appropriate jurisdiction within six calendar months of the date of the dismissal of the indictment or information, or, if no regular grand jury is in session in the appropriate jurisdiction when the indictment or information is dismissed, within six calendar months of the date when the next regular grand jury is convened, which new indictment shall not be barred by any statute of limitations."

the existence and dismissal of the first indictment for "jurisdictional" purposes; and (4) § 3288 applies only where the dismissal of the original indictment was defective due to some grand jury defect or irregularity and not where the indictment is dismissed for failure to state an offense.

Section 3288 in its present form was enacted in 1964. Prior thereto a very similar statute, passed in 1934, was in effect.[23] In *United States* v. *Durkee Famous Foods*, 306 U.S. 68, 71 (1939), the Supreme Court found that Congressional intent concerning the section was best summarized by the following letter written by the United States Attorney General:

> ". . . legislation is recommended providing that in any case in which an indictment is found defective or insufficient for any cause, after the period prescribed by the statute of limitations has run . . . a new indictment may be returned at any time during the first succeeding term at which the grand jury is in session."

Congress's primary purpose in changing the language of the statute in 1964 was to correct a "loophole" in the law which occurred when it became possible to charge by information as well as indictment. As Senate Report No. 1414, 2 U.S. Code Cong. and Admin. News 3257-3258 (1964) explained:

> "The purpose of the proposed legislation is to amend sections 3288 and 3289 of title 18, United States Code, so as to provide that the provisions of those sections will extend to felony proceedings instituted by infor-

[23] This statute, 18 U.S.C. § 587, reads:

> "Whenever an indictment is found defective or insufficient for any cause, after the period prescribed by the applicable statute of limitations has expired, a new indictment may be returned at any time during the next succeeding term of court following such finding, during which a grand jury thereof shall be in session."

> mation as well as by indictment. The sections concern cases where a new indictment is returned after a prior indictment has been dismissed because of an error, defect, or irregularity with respect to the grand jury, or because it has been found otherwise defective. The amendments would therefore permit reindictment in similar cases where an information was filed after the defendant waived in open court prosecution by indictment."

There is nothing in the legislative history of § 3288 to indicate that Congress had any intention of otherwise altering the meaning or application of the section. Applying this legislative history and the judicial interpretations of the pre-1964 version of the statute we conclude that appellees' contentions must be rejected.

Concerning appellees' contention that the second indictment should be dismissed because it charges different offenses, we find nothing in the cases cited by appellees or the language of § 3288 to require this conclusion. The correct interpretation of § 3288 was stated by this court in *Mende* v. *United States*, 282 F.2d 881, 883-884 (9 Cir. 1960): "[the] underlying concept of § 3288 is that if the defendant was indicted within time, then approximately the same facts may be used for the basis of any new indictment within the next term, if the earlier indictment runs into legal pitfalls." Here, a reading of the two indictments shows that essentially the same facts were used to charge almost identical offenses. The indictments differ primarily in the omission in the second indictment of the charge that 18 U.S.C. § 78i(a) was also violated by appellees' activities. Allowing a second indictment to remedy legal deficiencies present in the first is the very purpose for which § 3288 was enacted.

Under § 3288 the dismissal of the first indictment must occur "after the period prescribed by the applicable stat-

ute of limitations has expired". Appellees argue that § 3288 cannot be applied to the conspiracy count because the statute of limitations had not run on that count until April, 1974 while the dismissal occurred on January 30, 1974—*before* the statute had run. This argument appears to be based on a misunderstanding of the prevailing rule used in computing periods of limitation in conspiracy cases. As this court stated in *Bergschneider* v. *Denver*, 446 F.2d 569 (1971), "the statute of limitations starts to run on the date of the last overt act alleged to have caused the complainant injury". The last overt act alleged in the first indictment was alleged to have occurred on December 31, 1968—almost a month before the first indictment was dismissed.[24]

Appellees next contend that the second indictment should have contained an allegation with respect to the first indictment and its disposition. We find no support for this argument in the cases cited by appellees. While it is true that criminal statutes of limitation have been characterized as jurisdictional (*Walters* v. *United States*, 328 F.2d 739, 743 (10 Cir. 1964)), nothing would be gained by requiring a second indictment to allege the dispositional history of the first. The fact that the first indictment was dismissed is part of the record of the case before the court. As was recognized in *Sanseverino* v. *United States*, 321 F.2d 714, 715 (10 Cir. 1963), "The government had no burden to offer formal proof of that which appears in the case record of the court for such is the cornerstone of judicial notice . . ."[25] Similarly, we see

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[24] In any case, 18 U.S.C. § 3289 provides that a new indictment may be returned within six calendar months where the defect is found *before* the expiration of the period of limitations.

[25] In *Sanseverino*, an indictment filed May 17, 1962 charged the filing of a false return on April 9, 1956. The Government offered no formal proof that the six-year statute of limitations had been tolled, but the court records showed that a complaint had been filed on March 30, 1962.

no need to plead information which is obviously a part of the case record.

In their final challenge to the applicability of § 3288, appellees cite two district court cases, *United States* v. *Moriarity*, 327 F. Supp. 1045, 1047-1048 (E.D. Wis. 1971), and *United States* v. *Distefano*, 347 F.Supp. 442, 444-445 (S.D. N.Y. 1972), holding that where an indictment is dismissed for failure to prosecute, reindictment is not possible once the statute of limitations expires. In each case the court recognized that when an indictment is dismissed because of technical defects or irregularity in the grand jury, a new indictment may be returned. In neither case did the court consider the precise situation here presented, i.e., where the court found the first indictment legally defective.

While the first clause of § 3288 appears to be aimed at dismissal resulting from irregularities in the grand jury, the second clause is much more general. It states that a new indictment or information may be refiled where the second "*indictment* or information filed after the defendant waives in open court prosecution by indictment *is found* otherwise *defective or insufficient for any cause.*" The same language (in italics), absent the words inserted in the 1964 amendment providing for proceedings commenced by information (in regular face type), was interpreted in *United States* v. *Main*, 28 F.Supp. 550 (S.D. Tex. 1939). There the court rejected an argument identical to that raised by appellees. Quoting from *United States* v. *Strewl*, 99 F.2d 474, 476 (2 Cir. 1938), the court observed that the purpose of the statute was "to prevent the escape of those who had been seasonably indicted but whose indictment was bad because of some corrigible mistake." 28 F.Supp. at 553.

Main and the dicta from *Strewl* were the prevailing law for almost thirty years until the 1964 amendment to

§ 3288. As noted previously, the purpose of Congress in modifying the statute was to expand its provisions to cover proceedings initiated by informations and not to change existing law in any other manner. We conclude from the language of § 3288, as well as from the section's history, that a second indictment may properly be returned within the prescribed six-months period where the dismissal of the first indictment is due to a legal defect, as well as in those cases where the dismissal results from defects or irregularities in the grand jury.

Conclusion

In summary, we conclude that (1) the market manipulation artificially depressing the market price of a security on a national securities exchange was an indictable offense under 15 U.S.C. 78j(b) and SEC Rule 10-b; (2) while the indictment was by no means a model pleading it was sufficient to charge the elements of the offense, and further information may be obtained through a bill of particulars; and (3) the statute of limitations prescribed by 18 U.S.C. § 3282 was tolled by the provisions of § 3288.

Reversed and remanded for further proceedings consistent with this opinion.

SNEED, Circuit Judge: (Concurring)

I concur in Judge Jameson's opinion which is written with his usual clarity and thoroughness. The law, as I read it, supports his conclusions.

However, I cannot let pass this opportunity to draw attention to the fact that so-called "public welfare offenses" [1] do not generally, and clearly not in this case, encounter the same demanding constitutional and interpretive standards applicable to other criminal offenses.

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[1] *See* Morissette v. United States, 342 U.S. 246, 255 (1951); Sayre, *Public Welfare Offenses*, 33 COL. L. REV. 55 (1933).

As Judge Jameson's opinion makes clear, neither section 10b of the Securities Exchange Act, 15 U.S.C. § 78j(b), nor Rule 10b-5, 17 C.F.R. § 240.10b-5, are interpreted narrowly when employed as a basis for criminal prosecution, even though a narrow interpretation is ordinarily considered proper with respect to statutes defining crimes. *United States* v. *Campos-Serrano,* 404 U.S. 293, 297 (1971); *United States* v. *Braverman,* 373 U.S. 405, 408 (1963). In this case, for example, we find an indictable offense charged in the indictment despite the fact that there exists no case, not even one imposing civil liability, in which substantially similar facts have been treated as a violation of section 10b and Rule 10b-5. These provisions have been applied herein to the conduct of the defendants no differently than they would have been in a civil action. The expansive interpretation necessary "to insure the maintenance of fair and honest exchanges," section 2 of the Securities Exchange Act, 15 U.S.C. § 78b, employed in civil actions is employed by us in this criminal case. Majority opinion, *supra* at 10-11. This is done even though Professor Bromberg cites only eight cases in which violations of section 10b and Rule 10b-5 have served as the basis of criminal prosecution. 3 A. Bromberg, Securities Law: Fraud, § 10.3 at 241 (1975). Professor Loss cites only a handful more. 3 Loss, Securities Regulation, at 1449 n.15 (1961). Also it is done even though the Supreme Court, speaking through Mr. Justice Rehnquist, recently observed:

> "When we deal with private actions under Rule 10b-5 we deal with a judicial oak which grew from little more than a legislative acorn. Such growth may be quite consistent with the congressional enactment and with the role of the federal judiciary in interpreting it, see *J. I. Case* v. *Borak, supra,* but it would be disingenuous to suggest that either Congress in 1934 or the Securities and Exchange Commission in 1942 foreordained the present state of the law with respect to Rule 10b-5." *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 737 (1975).

"Employment of manipulative and devious devices" has a breadth, we assert, which permits us to find an indictable offense when it is necessary to do so "to insure the maintenance of fair and honest markets." The resemblance from an analytic viewpoint between our approach and that employed in *Shaw* v. *Director of Public Prosecutions,* 2 A.E.R. 452 (1961), where the House of Lords recognized that the common law crime of corrupting public morals requires a residual power to proscribe unanticipated wickedness *contra bonos mores,* strikes me as disturbingly close.[2] To protect and preserve honest markets we assert the residual power derived from a broad statute and rule to proscribe conduct surrounding a corporate takeover never heretofore branded improper by judicial decision, Commission rule or determination, or explicit Congressional act. And yet I am convinced that our assertion of this authority is in keeping with existing law.

The concern to avoid the taint of *ex post facto* application of a statute, a concern evidenced by the Supreme Court in *Bouie* v. *City of Columbia,* 378 U.S. 347 (1964), where the Court refused to permit the application of a new and unusual interpretation of a state criminal statute to conduct taking place prior to the new interpretation, only feebly survives in the area of section 10b criminal prosecution. In this case, we are untroubled by the fact that never before has the section and rule been applied to a similar situation. Furthermore, in fixing criminal liability under section 10b and Rule 10b-5, we attach reduced importance to assertions of vagueness. The fact that men of common intelligence—or lawyers and judges for that matter—"must necessarily guess at its meaning and differ as

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[2] Hart, Law, Liberty, and Morality, (1963) contains a discussion of *Shaw* and related problems.

to its application,"[3] does not require that we declare this section 10b void for vagueness. *Cf. Coplin* v. *United States*, 88 F.2d 652 (9th Cir. 1937), *cert. denied*, 301 U.S. 703 (1937) (very similar language of section 17(a) of the Securities Act of 1933 held not vague); *Hughes* v. *SEC*, 139 F.2d 434 (2d Cir. 1943) (section 17(a) not vague). We heed not the command:

> "No one may be required at peril of life, liberty, or property to speculate as to the meaning of penal statutes. All are entitled to be informed as to what the state commands or forbids."
>
> *Lanzetta* v. *New Jersey*, 306 U.S. 451, 453 (1939).

Rather we respond to stern and demanding fatalism reflected in this passage appearing in *Nash* v. *United States*, 229 U.S. 373, 377 (1913):

> "[T]he law is full of instances where a man's fate depends on his estimating rightly, that is, as the jury subsequently estimates it, some matter of degree. If his judgment is wrong, not only may he incur a fine or a short imprisonment . . . ; he may incur the penalty of death."

Finally, all these things we do while fully aware that under section 32(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78ff(a), the intent necessary to support a conviction is merely that of intending to do the acts prohibited, rather than intent to violate the statute. *United States* v. *Schwartz*, 464 F.2d 499, 509 (2d Cir. 1972). Proof of an "evil motive" appears unnecessary. *Id.* at 510, *citing* Loss, Securities Regulation. Moreover, it has been held

[3] *See* Connally v. General Construction Co., 269 U.S. 385, 391 (1926).

that to avoid imprisonment on the ground of "no knowledge of such rule or regulation" requires more than the defendant merely asserting that he did not know that his manipulative activity was fraudulent under Rule 10b-5. *See United States* v. *Lilly*, 291 F. Supp. 989 (S.D. Tex. 1968). The propriety of eliminating *scienter* or *mens rea* in statutes designed to serve a regulatory purpose has again been recognized by the Supreme Court in a recent decision. *See United States* v. *Park*, 421 U.S. 658 (1975).

An expansive statute under which the prosecution encounters such reduced obstacles imposes a heavy responsibility upon the prosecutor. Many are his potential targets and few are the standards by which the exercise of his discretion can be measured. *See Grayned* v. *City of Rockford*, 408 U.S. 104, 108-9 (1972). His decision to prosecute, no less than his failure to prosecute, may subject him to legitimate criticism. Whatever his decision, it is likely to be one in keeping with the political realities within which he functions. This is a part of the price that this type of statute compels us to pay.

Thus, although I have no choice but to join my brothers, I find no satisfaction or pleasure in doing so.

[FILED
July 8, 1976
EMIL E. MELFI, JR.]

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 75-1222

UNITED STATES OF AMERICA, *Appellant*,

v.

DAVID B. CHARNAY, CHESTER C. DAVIS, HOWARD R. HUGHES, ROBERT A. MAHEU, *Appellees*.

Order

Before: BROWNING and SNEED, Circuit Judges, and *JAMESON, District Judge

Appellees Charnay, Davis and Maheu have petitioned for a rehearing, contending, *inter alia*, that the decision of this court entered May 7, 1976, is in direct conflict with the decision of the Supreme Court in *Ernst & Ernst* v. *Hochfelder*, 96 S.Ct. 1375, entered March 30, 1976. Prior to filing its opinion this court considered the effect of *Ernst & Ernst* and concluded that our opinion was not in conflict with the holding in that case. After re-examination of the opinion in *Ernst & Ernst* in the light of the petition for rehearing, we reach the same result, but deem it advisable to enter this supplemental order explaining and clarifying the reasons for our conclusion.

Ernst & Ernst v. *Hochfelder* was a civil action for damages for alleged negligent conduct. The issues before the

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* Honorable William J. Jameson, Senior United States District Judge, District of Montana, sitting by designation.

Court and its conclusions are summarized in the following excerpts from the Court's opinion:

> We granted certiorari to resolve the question whether a private cause of action for damages will lie under § 10(b) and Rule 10b-5 in the absence of any allegation of "scienter"—intent to deceive, manipulate, or defraud. 421 U.S. 909, 95 S.Ct. 1557, 43 L.Ed.2d 773 (1975). We conclude that it will not and therefore we reverse. [96 S.Ct. 1381]
>
> . . .
>
> Use of the word "manipulative" is especially significant. It is and was virtually a term of art when used in connection with securities markets. It connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities. [96 S.Ct. 1384]
>
> . . .
>
> When a statute speaks so specifically in terms of manipulation and deception, and of implementing devices and contrivances—the commonly understood terminology of intentional wrongdoing—and when its history reflects no more expansive intent, we are quite unwilling to extend the scope of a statute to negligent conduct.
>
> Recognizing that § 10(b) and Rule 10b-5 might be held to require proof of a more than negligent nonfeasance by Ernst & Ernst as a precondition to the imposition of civil liability, respondents further contend that the case should be remanded for trial under whatever standard is adopted. Throughout the lengthy history of this case respondents have proceeded on the theory of liability premised on negligence, specifically disclaiming that Ernst & Ernst had engaged in fraud or intentional misconduct. In these circumstances we think it inappropriate to remand the action for further proceedings. [96 S.Ct. 1391]

This case obviously involves more than negligent conduct. Appellees argue, however, that in holding that the indictment was not fatally defective by reason of its purported failure to allege a specific intent to defraud our decision is contrary to the holding in *Ernst & Ernst*. Appellees misconstrue the basis of our disposition of this issue.

Although we did state that the cases have held that there is no requirement of proof that a defendant knew he was violating a particular S.E.C. rule, we did not hold that scienter *per se* was not a required element of the offense. Rather we noted that it was necessary for the prosecution to show an intentional act with "a realization on the defendant's part that he was doing a wrongful act." Similarly, Judge Sneed in his concurring opinion noted that "the intent necessary . . . is merely that of intending to do the acts prohibited, rather than intent to violate the statute." These statements are consistent with the holding in *Ernst & Ernst*.

Specific allegations in the indictment charging the requisite mental state and scienter include the following:

> Count II charges that the defendants and their coconspirators "did unlawfully, wilfully and knowingly, in connection with the purchase and sale of securities, to wit, the common stock of Air West, directly and indirectly, by the use of the means and instrumentalities of interstate commerce and the mails and the facilities of a national securities exchange, (a) employ a device, scheme, and artifice to defraud, (b) make untrue statements of material facts and omit to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, and (c) engage in acts, practices and courses of business which operated as a fraud and deceit upon purchasers and sellers of Air West securities."

> Count III charges that the defendants and their coconspirators "did devise and intend to devise a scheme and artifice to defraud the directors and stockholders of Air West, which said scheme and artifice to defraud is set forth more fully in paragraphs 13 and 14a through 14e of Count I of this indictment."

Paragraph 13 of Count I describes the means by which the conspiracy would be carried out. Paragraph 14 lists overt acts committed in furtherance of the conspiracy.

We conclude that these and other similar allegations in the indictment are sufficient to charge the requisite intent and scienter under *Ernst & Ernst*.

The panel as constituted in this case has voted to deny the petition for rehearing and to reject the suggestion for a rehearing in banc.

The full court has been advised of the suggestion for in banc rehearing, and no judge of the court has requested a vote on the suggestion for rehearing in banc. Fed. R. App. P. 35(b).

The petition for rehearing is denied and the suggestion for a rehearing in banc is rejected.

Nos. 76-337 and 76-356

FILED
NOV 17 1976
MICHAEL RODAK, JR., CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1976

CHESTER C. DAVIS, PETITIONER

v.

UNITED STATES OF AMERICA

DAVID B. CHARNAY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

ROBERT H. BORK,
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Solicitor to the Commission,

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In the Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-337

CHESTER C. DAVIS, PETITIONER

v.

UNITED STATES OF AMERICA

No. 76-356

DAVID B. CHARNAY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 27a-57a) is reported at 537 F. 2d 341. The order of the district court is unreported (Pet. App. 19a-24a).[1]

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[1] "Pet. App." refers to petitioner Davis' appendix (No. 76-337). References beginning with roman numberals denote the count and paragraph numbers of the indictment. "Pet." refers to the Davis petition. "C. Pet." refers to the Charnay petition (No. 76-356).

JURISDICTION

The judgment of the court of appeals was entered on May 7, 1976. A timely petition for rehearing and suggestion for rehearing *en banc* was denied on July 8, 1976 (Pet. App. 58a-61a). On July 28, 1976, Mr. Chief Justice Burger extended petitioner Davis' time for filing his petition (No. 76-337) until September 6, 1976, and the petition was filed September 3, 1976. On August 4, 1976, Mr. Justice Rehnquist denied petitioner Charnay's request for an extension of time to file his petition (No. 76-356). The petition was filed on September 7, 1976, and accordingly is untimely under Rule 22(2) of this Court's Rules. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether execution of a plan to cause the sale of large blocks of a corporation's stock, including short sales, for the sole purpose of depressing the market price of that stock in order to force a sale of the corporation's assets, is an unlawful manipulative device which violates Section 10(b) of the Securities Exchange Act as implemented by Securities and Exchange Commission Rule 10b-5.

STATUTE AND RULE INVOLVED

Section 10(b) of the Securities and Exchange Act, 48 Stat. 891, 15 U.S.C. 78j(b) and Securities and Exchange Commission Rule 10b-5, 17 C.F.R. 240.10b-5, are set forth at pages 2a-3a of petitioner Davis' appendix.

STATEMENT

Petitioners and defendants Howard R. Hughes[2] and Robert A. Maheu were indicted in the United States District Court for the District of Nevada. The indictment

[2]Mr. Hughes died on April 5, 1976. New York Times, April 6, 1976, p. 1, col. 1.

charged that the defendants had knowingly and wilfully conspired to, and did, use manipulative and deceptive devices involving interstate wire communications to depress artificially the price of the common stock of Air West, Inc. ("Air West"), on the American Stock Exchange, in violation of Section 10(b) of the Securities Exchange Act of 1934 ("Securities Exchange Act"), 15 U.S.C. 78j (b) and 78ff, and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5, and of the conspiracy and wire fraud statutes, 18 U.S.C. 371 and 1343 (Pet. App. 8a-11a; I 11, 12, 13, 14).[3]

The allegations of the indictment were as follows:[4] In August 1968, defendant Hughes, who was the sole stockholder of the Hughes Tool Company ("Hughes Tool") (Pet. App. 6a; I 1), instructed defendant Maheu, the chief executive officer of Hughes/Nevada Operations, a company controlled by defendant Hughes and Hughes Tool (Pet. App. 7a; I 3), and petitioner Davis, an attorney who acted as counsel for Hughes Tool (Pet. App. 6a; I 2), to make an offer on behalf of Hughes Tool to purchase Air West by acquiring its assets for cash at a price designed to yield approximately $22 per share to Air West stockholders (Pet. App. 7a-8a; I 8). On or about December 28, 1968, a bare majority of Air West's stockholders voted to accept the Hughes Tool offer (Pet. App. 8a; I 10). That same day, however, Air West's board of directors rejected the offer by a vote of 13 to 11 (Pet. App. 8a; I 10).

[3]A prior indictment against these defendants had been dismissed by the district court on January 30, 1974 (Pet. App. 48a). The second indictment, which is the subject of this appeal, was returned within the six-month re-indictment period specified in 18 U.S.C. 3288 (Pet. App. 53a).

[4]The allegations of the indictment are assumed to be true for purposes of determining whether the indictment states an offense against the United States. *United States* v. *A & P Trucking Co.*, 358 U.S. 121, 126, n. 5; *United States* v. *Howard*, 352 U.S. 212, 214-215.

Following the rejection, petitioner Davis, and defendants Hughes and Maheu attempted by various means to induce the Air West directors who had voted against the Hughes Tool offer to change their votes (Pet. App. 9a; I 13). As part of this effort, these defendants represented to the stockholders of Air West, and to others, that if the Hughes Tool offer were rejected, the price of the common stock of Air West would decline substantially (Pet. App. 9a; I 14a).

On December 31, 1968, these defendants, with the assistance of petitioner Charnay and certain other persons, conspired to depress the market price of Air West stock on the American Stock Exchange (Pet. App. 9a-10a; I 14a-c). Petitioner Davis and defendants Hughes and Maheu entered into agreements with petitioner Charnay and with unindicted co-conspirators Herman Greenspun and George Crockett, whereby petitioner Charnay, and Greenspun and Crockett were to sell shares of Air West common stock on the American Stock Exchange (Pet. App. 10a; I 14b). Greenspun and Crockett agreed to sell 27,000 shares which they owned. Petitioner Charnay agreed to sell "short" 59,100 shares (Pet. App. 12a; Overt Acts, para. e, g, i). Petitioner Davis, and defendants Hughes and Maheu agreed to reimburse petitioner Charnay for whatever losses he might sustain in his short sales, and they assured Greenspun and Crockett that they would receive $22 for each share they sold, regardless of the price at which their stock was actually sold (Pet. App. 10a; I 14b).[5]

[5]Further to induce the non-approving directors to change their votes, petitioner Davis, and defendants Hughes and Maheu, that same day, caused telegrams to be sent to those directors threatening them with the institution of lawsuits if they did not change their votes (Pet. App. 11a; I 14d). The threats were carried out when, that same day, petitioner Davis and defendants Hughes and Maheu caused certain Air West shareholders and directors to file lawsuits against the non-approving directors, charging that their rejection of the Hughes Tool offer constituted a breach of the fiduciary obligation they owed to Air West's shareholders (Pet. App. 11a; I 14d-e). Additionally, petitioner Davis and defendants Hughes and Maheu caused the issuance of court orders directing the seizure of the common stock of Air West owned by the non-approving directors (Pet. App. 11a; I 14e).

All these sales were effected on December 31, 1968 (except that petitioner Charnay was able to sell short only 19,100 shares) (Pet. App. 12; Overt Acts, para. e, g, i). The sale contributed to and caused a decline that day in the price of Air West common stock on the American Stock Exchange from $18 per share to $15.75 (Pet. App. 10a; I 14c).

Later that same day, as a result of defendants' activities, Air West reversed its earlier position and contracted to sell its assets to Hughes Tool (Pet. App. 12a; Overt Acts, para. j).

The district court dismissed the indictment on the ground that it failed to state an offense (Pet. App. 19a-24a). On appeal by the United States, the court of appeals reversed and remanded for further proceedings. It held (Pet. App. 41a):

> Here the Government has alleged that the appellees in selling their Air West stock purposely sought to depress the market for the stock, and in fact achieved this result, with the object and effect of deceiving the shareholders and directors of Air West in Hughes' takeover attempt. Such conduct falls within the type of activity which Congress sought to prohibit in enacting the Securities [and Exchange] Act and which Rule 10b-5 explicitly prohibits. It constitutes an indictable offense.

In an order denying a petition for rehearing and suggestion for rehearing *en banc*, the court held that the indict-

ment contained allegations "sufficient to charge the requisite intent and scienter under *Ernst & Ernst* [v. *Hochfelder,* 425 U.S. 185]" (Pet. App. 61a).[6]

ARGUMENT

1. Petitioners contend that the court of appeals erred in holding that the indictment states an offense under Section 10(b) of the Securities and Exchange Act (15 U.S.C. 78j(b)) and Rule 10b-5. In the present posture of the case, however, there is no occasion for the Court to consider that contention.

The district court dismissed the indictment, and the court of appeals reinstated it by reversing the dismissal. The case thus is in the same posture as if the district court had denied petitioners' motion to dismiss the indictment. Such an order would not be appealable (*Heike* v. *United States,* 217 U.S. 423; *Parr* v. *United States,* 351 U.S. 513), because such interlocutory determinations do not terminate the litigation; permitting appeals could thus seriously delay expeditious administration of the criminal law. Cf. *United States* v. *Ryan,* 402 U.S. 530; *Cobbledick* v. *United States,* 309 U.S. 323.

Petitioners have shown no extraordinary circumstances that would warrant this Court now to decide the preliminary question whether the indictment charges an offense. Indeed, the Court may never have to decide that question, since petitioners could be acquitted at their trial, or, if convicted, the court of appeals could reverse their conviction on grounds not warranting review here. If and when petitioners are convicted and their conviction is affirmed, the legal issue petitioners raise will have

[6]The court of appeals stayed its mandate until disposition of these petitions. None of the defendants is in custody.

been clarified and sharpened by the development of a full record detailing the precise nature and effect of their actions. If the Court deems the legal issue sufficiently important to warrant review, that would be the appropriate occasion therefor. Cf. *Heike* v. *United States, supra,* 217 U.S. at 430; *Parr* v. *United States, supra.*[7]

2. The court of appeals correctly held that the indictment charged a violation of Section 10(b) and Rule 10b-5. That ruling did not rest, as petitioners state, "solely on the basis" of some general purpose of the securities laws (Pet. 5; C. Pet. 6), but because the court found that the indictment "alleged that the * * * [defendants] in selling their Air West stock purposely sought to depress the market for the stock, and in fact achieved this result * * *" (Pet. App. 41a).[8] They were accordingly engaged in a "scheme, or artifice to defraud," and an "act, practice, or course of business which operate[d] * * * as a fraud or deceit" upon all other sellers of Air West stock, as well as on its other stockholders and its directors, within the meaning of the quoted terms as used in

[7]After a trial, if petitioners are convicted, this Court could review the court of appeals' reversal of the district court's dismissal of the indictment. *E.g., Toledo Scale Co.* v. *Computing Scale Co.,* 261 U.S. 399, 418; *Hamilton-Brown Shoe Co.* v. *Wolf Bros. & Co.,* 240 U.S. 251, 257-258.

[8]The district court similarly characterized the allegations of the indictment as charging the defendants with having "cause[d] substantial blocks of a security to be sold on a national securities exchange for the purpose of artificially depressing the market price of the security * * * " (Pet. App. 23a).

Although petitioners state that "[a]ccording to the Court of Appeals, the conduct at issue is 'certain guarantees against trading losses.' (28a.)" (Pet. 15; see also, C. Pet. 14), the quoted portion of the opinion of the court of appeals refers to that court's characterization of the first indictment, not the indictment involved in the present case (Pet. App. 27a-28a).

Rule 10b-5.[9] Their conduct accordingly violated Section 10(b), which makes it illegal to employ, in connection with the purchase or sale of any security, "any manipulative or deceptive device or contrivance" in contravention of the Commission's rules.

Petitioners contend that activities wilfully undertaken for the purpose of raising or depressing the market price of stock do not constitute a manipulation within the meaning of Section 10(b) and Rule 10b-5 unless (1) the activities are entered into for the purpose of inducing the purchase or sale of securities by others, and (2) the activities give the appearance of trading but do not involve actual transactions. As petitioners recognize (Pet. 18; C. Pet. 16), however, those are the elements which are necessary to show a "manipulation of security prices" in violation of Section 9(a)(2) of the Securities Exchange Act, 48 Stat. 889, 15 U.S.C. 78i(a)(2).

If Congress had intended to limit the prohibition against manipulative schemes and devices to those that Section 9 (a) prohibits, it would not have prohibited in Section 10(b) those devices and contrivances that contravene the Commission's rules. Congress deliberately included in the Act both kinds of statutory prohibition against manipulative activity. It authorized the Commission to make the judgment that investors are as seriously injured when security prices are manipulated for a purpose other than inducing purchases and sales of securities by others, which Section 10(b) bars, as when the manipulation has such a purpose and thus falls under Section 9(a)(2).

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[9]Rule 10b-5 makes it unlawful, in connection with the purchase or sale of a security,

(a) To employ any device, scheme, or artifice to defraud,

* * * * *

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person * * *.

Nor are Section 10(b) and Rule 10b-5 limited to manipulative or deceitful devices based on artificial transactions, such as wash sales or matched orders. Those transactions are expressly proscribed by Section 9(a)(1), 15 U.S.C. 78i(a)(1). Section 10(b) was added to the Act, as a "catchall" clause to enable the Commission to deal with " 'any other cunning devices' " by which markets might be manipulated. *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 202 (quoting the testimony of Thomas G. Corcoran, a spokesman for the drafters). Proscribed conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities (*Ernst & Ernst, supra*), may include actual trading. Cf. Section 9(a)(2), 15 U.S.C. 78i(a)(2).

Contrary to petitioners' contention, the decision of the court of appeals does not conflict with the scienter requirement of *Ernst & Ernst* v. *Hochfelder, supra.* That case involved a private claim for damages under Section 10(b) and Rule 10b-5, based on the defendant's allegedly negligent non-feasance. The Court held that a damage action based on these provisions will not lie "in the absence of an allegation of intent to deceive, manipulate, or defraud on the part of the defendant." 425 U.S. at 187-188.

In this case, in contrast, the indictment charges that the defendants "*wilfully and knowingly*" employed "manipulative and deceptive devices" (emphasis added) (Pet. App. 8a-9a; I 12), and that the defendants "*did devise and intend to devise* a scheme and artifice to defraud the directors and stockholders of Air West" (emphasis added) (Pet. App. 14a, 15a; III 2, IV 2). The indictment alleges that petitioners caused "substantial blocks of * * * [Air West stock] to be sold on a national securities exchange for the purpose of artificially depressing the market price of" (Pet. App. 23a)

that stock, and that they "in fact achieved this result, with the object and effect of deceiving the shareholders and directors of Air West * * *" (Pet. App. 41a). The charge in this case, unlike that in *Ernst & Ernst,* was wilfull and knowing misconduct, not mere negligent non-action. As the court of appeals explained in denying rehearing (Pet. App. 60a), it—

> did not hold that scienter *per se* was not a required element of the offense. Rather we noted that it *was necessary for the prosecution to show an intentional act* with "a realization on the defendant's part that he was doing a wrongful act." [Emphasis added.]

Such an intent and realization of wrongdoing are plainly alleged.

The decision of the court of appeals does not conflict with *Marsh* v. *Armada Corp.,* 533 F. 2d 978 (C.A. 6). In *Marsh* the court concluded that an alleged manipulative scheme involving elimination of stock dividends did not violate Rule 10b-5 because there had been complete advance disclosure of the defendants' intention to eliminate dividends; there was, therefore, no deceit or fraud on any persons.

In this case the defendants did not disclose their intention to drive down the market price of Air West stock (Pet. App. 44a). The alleged scheme operated as a fraud on anyone who sold Air West stock during the period when its price was artificially depressed as a result of defendants' activities (Pet. App. 10a; I 14c) since they were the victims of petitioners' scheme to drive the price down. Protection against such conduct is the fundamental purpose of the 1934 Act (*Ernst & Ernst, supra,* 425 U.S. at 195) and of Rule 10b-5 (see n. 9, *supra,* p. 8, and discussion, *supra,* p. 9).

Petitioners claim that the indictment denies their Fifth and Sixth Amendment rights, because Rule 10b-5 does not specify what fraud it proscribes, so that petitioners have "no firm idea of what the government claims [they] did that was unlawful" (Pet. 20-21; C. Pet. 18-19).[10] The Commission adopted the rule, however, precisely because it is impossible to define all of the fraudulent and manipulative schemes devious ingenuity can conceive. Rule 10b-5 prohibits "*all* fraudulent schemes in connection with the purchase or sale of securities whether * * * [n]ovel or atypical." *Superintendent of Insurance* v. *Bankers Life & Casualty Co.,* 404 U.S. 6, 11, n. 7. Petitioners' alleged scheme was fraudulent because it involved a secret device artificially to depress the market price of stock.

Contrary to petitioners' argument, there is nothing novel in the holding of the court of appeals that a market manipulation effected for the purpose of creating an artificial price perpetrates a fraud upon the investing public (Pet. 15-22; C. Pet. 14-19). This holding is reflected in English common law. In *Scott* v. *Brown,* 2 Q.B. 724 (1892), the parties had conspired to purchase shares

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[10]Petitioners' assertion that "[i]t is impossible to find in the indictment who it was that petitioner[s] allegedly intended to deceive or defraud * * * " (Pet. 13; see also, C. Pet. 12-13) ignores the allegations of the indictment that the persons defrauded were, among others, "purchasers and sellers of Air West securities" (Pet. App. 13a; II 2) and "directors and stockholders of Air West" (Pet. App. 14a, 15a; III 2, IV 2), and that as a result of defendants' fraudulent and manipulative activities "Air West" (stockholders who sold their stock in the declining market * * * [received] the proceeds from their sales at artificially depressed prices" (Pet. App. 10a). If petitioners require more definite information they may seek it through a bill of particulars (Pet. App. 47a). Accord, *Tasby* v. *United States,* 504 F. 2d 332 (C.A. 8); *Sullivan* v. *United States,* 411 F. 2d 556 (C.A. 10).

in a company in order to create the appearance of a bona fide market for the shares and that the shares were trading at a premium. The court held the arrangement to be a fraud. See also, *Reg.* v. *Aspinall,* 1 Q.B.D. 730, affirmed, 2 Q.B.D. 48 (1876); *Bedford* v. *Bagshaw,* 4 H. & N. 538, 157 Eng. Rep. 951 (1859); *Rex* v. *DeBerenger,* 3 M. & S. 67, 105 Eng. Rep. 536 (K.B. 1814).

Moreover, prior to the federal securities laws, manipulative activities were held to be unlawful under the federal mail fraud statute. Speaking of a defendant who used a pool to inflate the price of a stock, a district court held: "the substitution of an artificially stimulated and controlled market for an appraisal of the stock in an open and free market" constituted fraud. *United States* v. *Brown,* 5 F. Supp. 81, 84 (S.D. N.Y.), affirmed on other grounds, 79 F. 2d 321 (C.A. 2), certiorari denied *sub nom. McCarthy* v. *United States,* 296 U.S. 650. Similarly, in *Harris* v. *United States,* 48 F. 2d 771 (C.A. 9), a mail fraud case, the court of appeals observed that the violator's "primary purpose * * * was to manipulate * * * stock upon the stock exchanges so that it would have an apparently steadily increasing market value." *Id.* at 775. A distinguished commentator has said of that case that "[t]he cardinal misrepresentation [was] that the price was fixed in a free market, whereas in fact it was fixed by defendant * * *." Berle, *Stock Market Manipulation,* 38 Colum. L. Rev. 393, 397 (1938). Similarly, in the present case, the court of appeals found that the wilfull conduct of defendants in "representing to Air West stockholders and directors that the market would decline if the Hughes tender offer were rejected and their subsequent conduct in driving down the market price without revealing that the

decline was not due to the free operation of market forces * * * operate[d] as a deceit on the market place * * * " (Pet. App. 44a-45a).[11]

CONCLUSION

For the foregoing reasons the petitions for a writ of certiorari should be denied.

Respectfully submitted.

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NOVEMBER 1976.

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[11]Petitioners suggest that this statement by the court of appeals is contrary to *TSC Industries, Inc.* v. *Northway, Inc.,* No. 74-1471, decided June 14, 1976 (Pet. 21-22, n. 7; C. Pet. 19 n.). But *Northway* held only that there is no market manipulation if stock is purchased "wholly independently for proper corporate and investment purposes * * *" (slip op. 24).

Supreme Court, U. S.
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IN THE

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v.

UNITED STATES OF AMERICA, *Respondent.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONER

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The government's brief makes clear that the difference between the parties as to the scope and application of Rule 10b-5 is a fundamental one, thus emphasizing the need for an early and authoritative determination of the issue by this Court.

The government asserts that merely selling stock to depress the price is, in and of itself, a "scheme, or artifice to defraud" and thus a violation of the Rule. (Brief in Opposition ("Br.") at 7.) The nature of the "fraud" is nowhere identified. The government does not deny that the sales were real, not fictitious,

and that the stock was not sold in a deceitful manner. Indeed, in its statement of the question presented, the government says that the purpose of the conduct at issue was not to deceive or defraud at all, but rather "to force a sale of the corporation's assets". (Br. at 2.)

The government's position boils down to the assertion that Rule 10b-5's reference to a "scheme to defraud" may be expanded by liberal and flexible judicial interpretation so as to outlaw conduct that is not deceptive, and that Congress specifically declined to proscribe when it expressly defined a trading manipulation in Section 9 of the Securities Exchange Act. (*Compare* Br. at 8 *with* petition at 16-17.) Whatever the merit of the government's position, the dispute between the parties as to the proper role of Rule 10b-5 in the enforcement of the federal securities laws plainly presents an important question.

The government does not contend otherwise, but argues only that this Court's determination of the question should be delayed until such time as the petitioner may have been convicted of the novel offense created by the Court of Appeals, and the Court of Appeals has again decided the same question that is now presented by the instant petition. The course urged by the government is fraught with unfairness and inefficiency.

It would subject petitioner and the District Court to the burden and expense of a trial that would be completely unnecessary if the legal issue presented by the petition were decided in petitioner's favor. As this Court recognized in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 739-743 (1975), courts have an

obligation to decide legal issues that can obviate the need for time-consuming proceedings designed to prove factual contentions that may ultimately be determined to be legally insufficient. In *Blue Chip Stamps* itself, this Court granted certiorari to review a decision of the Court of Appeals that had reversed the District Court's dismissal of the complaint for failure to state a claim on which relief might be granted. 421 U.S. at 727.[1] This case is in the same procedural posture.

The fact that this case arises in a criminal context is an additional reason for review by the Court at this time. In *Blue Chip Stamps, supra,* 421 U.S. at 740, the Court recognized that the very pendency of even a civil action under the securities laws imposes collateral burdens on the defendant that ought not be prolonged by failure to decide a dispositive legal issue. That principle applies with special force here where the pendency of criminal proceedings has continuing adverse effects on petitioner.

Moreover, a trial conducted pursuant to the decision of the Court of Appeals, which admittedly offers little other than "political realities" to distinguish lawful conduct from an indictable offense (Appendix at 57a),

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[1] This Court has frequently granted certiorari to review the legal issues presented by a Court of Appeals' reversal of a district court's grant of a dispositive motion addressed to the complaint. For example, the Court granted certiorari in *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 191 (1976), to resolve the legal question presented by the Court of Appeals' reversal and remand of the district court's grant of a motion for summary judgment. Similarly, the Court recently granted certiorari in *Santa Fe Industries, Inc.* v. *Green,* 45 U.S.L.W. 3249 (U.S. Oct. 4, 1976) (No. 75-1753), to review the decision of the Court of Appeals reversing the district court's grant of a motion to dismiss for failure to state a claim on which relief might be granted.

would be unjust and inefficient: the decision of the Court of Appeals provides neither guidance to the district court as to how to instruct the jury, nor notice to the petitioner of the nature of the crime with which he is charged. As to instructing the jury, the decision of the Court of Appeals and the argument of the government would make it a crime to sell stock for the purpose of depressing the price. A jury instruction based upon that standard would require a conviction in cases of undeniably lawful conduct such as, for example, that described at page 16 of the petition. There is plainly a present need for intelligent guidance as to the meaning of Rule 10b-5.

As to the nature of the offense charged, the government's brief simply compounds the confusion already engendered as to the nature of the charge against which petitioner is required to defend. At one point, the government's brief says that the victims of the claimed fraud were "all other sellers of Air West stock" (Br. at 7), even though it elsewhere concedes that petitioner did not induce such sales (Br. at 8.) At another point, the government's brief makes the delphic and contradictory pronouncement that the persons defrauded were purchasers of Air West securities. (Br. at 11.) Again, it is said in another place that the victim was "the market" (Br. at 13). It is also said variously that the victims of the claimed "fraud" were "other stockholders" of Air West and even "its directors".[2] (Br. at 7.)

The government is still unable to identify the nature of the claimed fraud. There is more than a little unfairness in the contention of the government that a

[2] No purchases or sales of stock by any such victims are alleged.

trial is necessary in order to identify with any precision the nature of the crime charged. (*Id.*) That is the function of an indictment in a criminal case. *Russell* v. *United States,* 369 U.S. 749 (1962). The failure of this indictment to do so is one more reason why this Court should not hesitate to decide the important questions presented by the petition.

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